

103

SECTION 8 HOUSING: WASTE AND MISMANAGEMENT

Y 4. G 74/7: H 81/33

Section 8 Housing: Waste and Misman...

HEARINGS

BEFORE THE

EMPLOYMENT, HOUSING, AND AVIATION SUBCOMMITTEE

OF THE

COMMITTEE ON GOVERNMENT OPERATIONS

HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

JULY 26, AND OCTOBER 6, 1994

Printed for the use of the Committee on Government Operations



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SECTION 8 HOUSING: WASTE AND MISMANAGEMENT

TUESDAY, JULY 26, 1994

HOUSE OF REPRESENTATIVES,
EMPLOYMENT, HOUSING, AND AVIATION SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2247, Rayburn House Office Building, Hon. Collin C. Peterson (chairman of the subcommittee) presiding.

Present: Representatives Collin C. Peterson, Floyd H. Flake, William H. Zeliff, Jr., Christopher Shays, and Frank D. Lucas.

Also present: Wendy Adler, staff director; Linda Thompson, professional staff member; June Saxton, clerk; and Judith A. Blanchard, minority deputy staff director, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN PETERSON

Mr. PETERSON. The committee will come to order. We apologize. We have got a lot of things going on this morning, so we are rearranging and asking you all to appear in one panel. What we are going to do is try to get through the statements before we have to break.

Apparently, the rules are that we have to break during this joint session, so we will take a break for however long that happens, and we will see how it goes. I would hope that you could stay and be here when we get back. We appreciate your being with us.

The subcommittee will be examining this morning waste and mismanagement in the Section 8 project-based assistance program. Most of us, I believe, are familiar with the Section 8 Voucher and Certificate Program, which provides rent vouchers to tenants who may use them in any building that will accept them that qualifies under the rules. A program I think that is not as well known is the Project-Based Program, which we are going to be examining today. In this program, HUD provides rent subsidies and in some cases HUD-insured mortgages to private projects, and they are actually allocated to the project.

This is a huge program. To date HUD has provided over \$131 billion in assistance to over 20,000 projects across the Nation. As the rent subsidies are tied to the project, not the tenant, tenants are often unable to move when a project goes bad, regardless of the living conditions, and we will see some of those cases here a little later.

As we begin this hearing, I want to clearly state that I am not interested in pointing fingers and placing blame. I think there is plenty of that to go around. What I am interested in is seeing if we can develop some permanent solutions to this situation. We began to investigate this program out of concern for residents trapped in these deplorable conditions.

A recent report by the HUD Inspector General found that 69 percent of the units failed to meet HUD's housing quality standards. The HUD Inspector General will tell us this morning that 20 percent of them are in serious trouble. So what is HUD doing about this? Apparently, the agency has failed to even inspect 61 percent of the projects that should have been inspected. When it does inspect, it does little or nothing to effect the repairs. I think there may be some reasons for that so I don't want to necessarily lay all the blame on HUD's door step, but the fact is that these problems are out there and they are not getting addressed.

What is it like to live in one of these troubled projects? The GAO recently looked at some properties in seven cities. It found families living in apartments with rats, exposed wires that could be deadly, leaking toilets, sinks, and roofs, and holes in the walls and ceilings. In Pompano Beach, FL, a child drowned in a lake next to his apartment complex after the owner kept delaying repairs of several holes in the fence between the complex and the lake.

I think it is inexcusable that HUD is not inspecting these properties or enforcing its own housing quality standards. HUD should not find out that a property is in poor condition from the local television news, a tenant's lawsuit, or a congressional hearing. The GAO and the HUD IG will both testify that HUD officials could not provide them with the most basic information on this program, such as the number of properties involved and their general condition.

Even when HUD does inspect, it is often a meaningless exercise because HUD officials do not follow up and ensure that problems are resolved. For example, the GAO found an owner whose property was inspected in 1993, but did not receive the inspection report from HUD until almost 1 year later. I don't think that even that can be blamed on the U.S. mail, although I am not sure in watching some of the television reports. The GAO also spoke with the HUD inspector of a project in New York City who said that the property hadn't improved in the 6 years that he had been inspecting it.

Now, HUD has an entire array of enforcement tools, such as civil penalties, putting the project in receivership, and denying rent increases, to force compliance with these housing standards. But quite often, most often they aren't used. The HUD IG will report that there is a culture at HUD that results basically in a wholesale disregard for the available enforcement tools.

If HUD doesn't effectively enforce its sanctions, the owners are going to get away with just about anything, and in some cases they are, while still taking millions of dollars in Federal rent subsidies while they do it, allegedly to provide safe, sanitary housing for low income tenants.

In addition, without inspections and sanctions, more and more properties are falling into the category of too far gone. Repairs es-

calate over time and then it becomes economically impossible for the owner to make the necessary repairs even if he wants to.

For example, the HUD IG audited Bethel Church Homes, a Section 8 project with 190 apartments in Athens, GA, and found that the project needed over \$2 million in repairs. The owner had not fixed the problems as they developed.

There are other ways that the Federal taxpayer is losing money. The rent for many of these apartments are higher than that for comparable apartments in the same neighborhood. There are reasons for these higher rents in some cases, but by law, Section 8 rents cannot be significantly higher than rents for similar apartments in the same area. GAO found a troubled Section 8 property in Chicago where the rent for a two-bedroom apartment was over \$800, and a comparable apartment in a building nearby was just over \$400.

Section 8 subsidies work for many projects. Why can't it work for others? Why can one well-maintained project be right next to a poorly maintained project in the same neighborhood with basically the same type of tenants? Today we will hear from two different owners whose properties are located right next door to each other, Edgewood I and Edgewood II right here in Washington, DC. The first property is in terrible shape; the second one is in good condition. As I said, they basically have the same kinds of tenants. We brought both of those owners here today to talk to us as we examine this issue.

Now, in fairness to HUD, I think that the more I look into this I can see that there are no easy policy solutions to the problems of this Section 8 housing program. But in spite of that, I think we must take steps to resolve these problems, and I think we need to do it now.

After today's hearing, I intend to develop legislation to address these problems similar to what we did on the one for one replacement law and some of the other issues we looked to in the public housing area. Hopefully, our witnesses today will also offer some suggestions that we can follow up on. I will now recognize the ranking member of the committee, the Honorable Bill Zeliff from New Hampshire, who has been working with me. We look forward to your statement.

Mr. ZELIFF. Thank you, Mr. Chairman. I will be just as brief as I can in the interest of time, but appreciate your calling this subcommittee together this morning to examine the problems that are associated with Section 8 project-based housing programs.

Mr. Chairman, Americans are compassionate people, and it is an inherent part of our American character to lend a hand to those in need. However, we also have a right to expect that the assistance we provide will be put to good use. We need accountability and we need good management practices which, if properly implemented, will eliminate and prevent waste and inefficiency. This is particularly true of our public assistance programs.

The Section 8 assisted housing program represents an important part of our effort to provide one of the most basic of human necessities—shelter. Of course, providing shelter means more than simply putting a roof over people's heads. Recipients of Section 8 assistance have a right to expect decent, safe, and sanitary housing.

Taxpayers also deserve to know that their dollars are being well used. Unfortunately, as we will hear today, this is not always the case. What we will hear about today are families that live in Section 8 housing units that routinely fail to meet HUD's housing quality standards. People live in rat and roach-infested apartments with no heat or air conditioning, leaking toilets and roofs, and holes in the walls and ceilings.

In some cases, the rents that are paid for these units are higher than the rents of comparable housing units in the area. All of this is paid for by the American taxpayer. HUD is supposed to inspect these housing units to ensure that they meet standards of quality. However, these inspections do not always occur nor does the agency adequately follow up on the inspections that are done to ensure that necessary repairs are done.

HUD also fails to aggressively take enforcement actions against delinquent project owners. It is estimated that 15 to 20 percent of Section 8 project-based housing is considered substandard, although a lack of data makes it difficult to get an exact figure. In fact, it could be said that the most troubling aspect of this issue may not be the existence of substandard housing. Rather, I am concerned over the general lack of information from HUD on the exact scope of the problem, as well as a general inability of the agency to take corrective action.

I also find it troubling that this subcommittee has held hearings to focus attention on various aspects of our troubled housing assistance programs and the response from this administration has been largely nonexistent. It becomes increasingly difficult to justify funding programs that are in such fundamental disrepair.

Mr. Chairman, I hope today's hearing will send a clear signal to HUD that we cannot continue to allow these problems to carry on. Whether the problem is welfare hotels or decrepit Section 8 housing units, we need a results-oriented strategy from the administration to solve these problems, not more excuses. We need a time line as to when certain things are going to get done. Many of these problems have existed for many years, and also carry over from other administrations, and I recognize that, but with the limited resources that we now have today, taxpayers' interests must be represented, and we need to look at not only these issues, but maybe extended into the financing end of it, maybe looking at the tax situation that has allowed some of this to exist, very complicated, very technical, but looking forward to the testimony and hopefully we can make some progress, Mr. Chairman.

Mr. PETERSON. Thank you, Mr. Zeliff, for that statement. We appreciate the work you have been doing. I would like to welcome the newest member of the Employment, Housing, and Aviation Subcommittee, a new Member from Oklahoma, Mr. Frank Lucas. We welcome you to the subcommittee. Do you have any statement? You don't have to, but it is up to you.

Mr. LUCAS. Just truly appreciate the opportunity to serve on the subcommittee with the chairman and the ranking member and think that it is indeed a privilege to be able to serve on Government Operations and think that we have a very serious role, as I understand this committee's oversight, making sure that the citizens' interests are well taken care of. Thank you, Mr. Chairman.

Mr. PETERSON. Again, welcome to the subcommittee, and we look forward to working with you as we proceed. We were going to have more panels, but we combined two of the panels.

Our first panel of witnesses are Judy England-Joseph, the Director of Housing and Community Development Issues with the General Accounting Office, who is accompanied by Dennis Fricke, Assistant Director for Housing and Community Development; and Susan Gaffney, back with us again, the Inspector General with the U.S. Department of Housing and Urban Development, who is accompanied by Chris Greer, who is also back with us again, assistant Inspector General for audit; and Nicolas Retsinas, the Assistant Secretary for Housing, Federal Housing Commissioner with HUD, who is accompanied by Helen Dunlap, Deputy Assistant Secretary for Multifamily Housing.

We appreciate very much you all being with us this morning and the work that you are doing. It is the custom of the Government Operations Committee investigative hearings to swear in all witnesses. Do any of you have any problem with being sworn in? If not, would you please rise and raise your right hand.

[Witnesses sworn.]

Mr. PETERSON. Thank you. Please be seated. Your statements are going to be included in the record without objection in their entirety. You can summarize, hit the high points, however you would like to proceed, so Ms. England-Joseph, would you begin.

STATEMENT OF JUDY A. ENGLAND-JOSEPH, DIRECTOR, HOUSING AND COMMUNITY DEVELOPMENT ISSUES, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY DENNIS FRICKE, ASSISTANT DIRECTOR

Ms. ENGLAND-JOSEPH. Thank you, Mr. Chairman, and members of the subcommittee. We are pleased to have the opportunity to testify today on matters affecting the Nation's ability to provide low-income families with decent housing. My testimony will focus on issues related to the housing and urban development Section 8, project-based assisted housing programs, which provide rental assistance to over 20,000 privately owned properties, and 1.5 million low income households nationwide at an estimated annual cost of about \$5.8 billion.

At your request, we looked at whether properties being subsidized by the Section 8 programs meet HUD's housing quality standards for safe, decent, and sanitary housing and whether HUD is effectively using its enforcement tools to ensure that the assisted properties are adequately maintained. You also asked us to provide our observations on actions either HUD or the Congress might take to help resolve situations in which these properties are very poorly maintained.

According to HUD's regulations and directives and the provisions of various contractual agreements, such as the housing assistance payment contract, owners of Section 8 project-based assisted properties are required to maintain assisted properties in good physical condition. HUD field officers, through various oversight functions, are supposed to ensure that this is the case. HUD is required to conduct inspections of assisted properties to assess the performance of management agents in operating a project, determine the condi-

tion of a property's buildings, grounds, and mechanical systems, and look at the interiors of a sample of units to determine whether the units meet the housing quality standards.

Our testimony is based on visits we made in June and July of this year to properties in both good and poor physical condition in seven locations throughout the country—Washington, DC, New York, Illinois, Texas, Florida, Nevada, and California.

We reviewed property files and discussed the properties' histories with HUD management, HUD officials and management agents, and some owners and tenants. Additionally, we reviewed contractual obligations between owners, lenders, and HUD, and the implications of HUD taking various actions when properties fail to meet housing quality standards.

Now, before I discuss the results of our work, we would like to show a brief videotape depicting the conditions in some of the assisted properties we visited.

[Video shown.]

Ms. ENGLAND-JOSEPH. As the videotape showed, physical conditions in the Section 8 assisted properties we visited ranged from very good to very poor. The properties in good physical condition shown in the video demonstrate that the Section 8 program can work. However, the video also showed that HUD is paying sizable rent subsidies for poor quality housing.

The focus of our testimony today is on the 10 properties in poor physical condition so that we could obtain a perspective on the severity of the problems and understand the factors that impede HUD's ability to enforce its housing quality standards.

In summary, we found the following: In 1993 HUD paid about \$7 million in rent subsidies to house over 1,200 families in the 10 distressed properties we visited. In some of these properties, many of the physical problems had been longstanding.

For example, Edgewood Terrace Apartments in Washington, DC, which was shown in the video, received unsatisfactory ratings in overall management operations from HUD from 1989 to 1993. A November 1992 review stated that "many occupied and vacant units are unfit for human habitation."

In stark contrast to this property is one which adjoins it called Edgewood Terrace II. Edgewood Terrace II is well maintained, both on the interior and exterior, and has a community center that offers several activities for its tenants. The unit rents for some of the distressed properties we visited were equal or higher than those of other properties in the same area whose physical condition and amenities are much better.

For example, the rent for a two-bedroom unit at Unity Apartments in New York City is \$1,100, while rent for a two-bedroom unit in a well-maintained unsubsidized property in the same general area is between \$600 and \$750 a month.

HUD has a wide range of enforcement tools intended to ensure that its subsidized housing is maintained according to housing quality standards, including applying civil money penalties and terminating the housing assistance payments contract.

HUD has used these tools sparingly and inconsistently. However, these tools, when used, can help to ensure that assisted properties are well maintained, but they do have certain limitations. For ex-

ample, civil money penalties only apply to owners of Section 8 assisted properties whose mortgages are ensured by HUD.

The termination of a housing assistance payment contract also poses problems in that HUD generally does not have the funding to provide tenants with long-term alternative housing assistance if they are displaced from a property receiving Section 8 project-based assistance. Further, if HUD applied the more severe enforcement penalties, such as termination of the housing assistance payments contract, low-income tenants could be displaced and the Federal Government could incur significant additional costs depending on the interpretation of laws requiring that properties continue to serve low-income tenants.

Administrative initiatives are under way to help HUD overcome some of the impediments to dealing with properties in serious disrepair. These initiatives deal with HUD's improving its information and financial systems as well as providing improvements in training to its staff. Further, various legislative proposals have been introduced, such as the reuse of recaptured Section 8 assistance to relocate tenants and an expansion of its civil money penalties.

While these actions are a step in the right direction, they do not resolve the immediate problems facing tenants currently living in the most severely distressed Section 8 assisted housing. Accordingly, we are recommending today that the Secretary of HUD begin immediately to develop a comprehensive strategy to address the very poor physical conditions under which some families supported by Section 8 project-based assistance are living.

As part of this strategy HUD should, through the use of its field staff, promptly identify all Section 8 assisted properties with severe physical problems and offer affected tenants temporary assistance to relocate to safe and decent housing. HUD should also systematically notify owners of the problems they identify and take appropriate enforcement action in cases in which owners do not bring their properties into compliance with the housing quality standards.

To the extent that budgetary or legislative constraints prevent HUD from addressing these conditions, we further recommend that the Secretary provide the Congress with an assessment of the resources and legislative changes the Department needs.

Mr. Chairman, the focus of our testimony today has been on some of the more severely distressed Section 8 project-based assisted properties and the need for HUD to take immediate action to improve the living conditions of tenants in these and other similarly distressed properties. However, HUD's effectiveness in dealing with these conditions and minimizing similar situations in the future will depend on the Department building the capacity necessary to manage its large inventory of assisted properties and identifying and successfully working with Congress and the Office of Management and Budget on the budgetary and legislative issues related to this matter.

In closing, Mr. Chairman, swift action is needed to address the very poor living conditions we found in our review. Our recommendation is not intended to be a paperwork exercise, the end of which may be years to come. It is instead a set of actions that

if taken will demonstrate HUD's commitment to enforcing its housing quality standards.

The Department's efforts to quickly address the conditions we found and to take enforcement action, where appropriate, will send a very clear signal to participants in HUD's assisted-housing programs that deplorable living conditions will not be tolerated and that HUD indeed is a force to be reckoned with in providing safe, decent, sanitary housing for low income people. That completes my statement. I would be happy to answer any questions you or the committee members might have.

[The prepared statement of Ms. England-Joseph follows:]

United States General Accounting Office

GAO

Testimony

Before the Employment, Housing
and Aviation Subcommittee,
Committee on Government Operations,
House of Representatives

For Release on Delivery
Expected at
10 a.m. EDT
Tuesday
July 26, 1994

FEDERALLY ASSISTED
HOUSING

Condition of Some Properties
Receiving Section 8
Project-Based Assistance Is
Below Housing Quality
Standards

Statement of Judy A. England-Joseph,
Director, Housing and Community Development Issues,
Resources, Community, and Economic Development Division



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the results of our work for this Subcommittee and for the Ranking Minority Member of the House Committee on Appropriations on the Department of Housing and Urban Development's (HUD) Section 8 project-based assisted housing programs. Under these programs, HUD pays a portion of the rent for low-income families living in privately owned rental housing.

HUD provides this assistance for over 20,000 privately owned properties nationwide at an estimated annual cost of \$5.8 billion. The mortgages for about 10,000 of these properties are also insured or held by HUD. Although many of these properties are considered to be in good physical condition, reports by HUD's field offices, HUD's Office of Inspector General, and the media have identified assisted properties where low-income families are living in very poor physical conditions. Concerned about these situations, you asked us to examine whether (1) the properties being subsidized by the Section 8 programs meet HUD's housing quality standards for safe, decent, and sanitary housing and (2) HUD is effectively using its enforcement tools to ensure that the assisted properties are adequately maintained. You also asked us to provide our observations on actions either HUD or the Congress might take to help resolve situations in which the properties are very poorly maintained.

Our testimony is based on visits we made in June and July 1994 to properties, in both good and bad physical condition, in seven locations throughout the country. (See app. I.) We selected these properties in consultation with HUD headquarters and field office staff. We reviewed property files and discussed the properties' history with HUD officials, management agents and some owners, and tenants. We also documented the rents charged for the properties we reviewed and compared these rents with those of other properties in the same area. In addition, we reviewed contractual obligations between owners, lenders, and HUD and the implications of HUD's taking various actions when properties fail to meet the housing quality standards.

In summary, we found the following:

- Physical conditions in the Section 8 assisted properties we visited ranged from very good to very poor. The properties in good physical condition demonstrate that the Section 8 program can work. However, conditions in some properties we visited clearly violate HUD's housing quality standards. These standards require, among other things, that tenants be provided with properly operating sanitary facilities, adequate security, properly operating heating and air conditioning, and ceiling and walls without serious defects. In the distressed properties we visited, families were housed in units with, among other things, leaking

toilets and sinks, exposed electrical wiring, holes in walls and ceilings, inoperative air conditioners and smoke detectors, missing and broken kitchen cabinets, and evidence of roach and rodent infestation. HUD does not know the full extent of these conditions in properties assisted under the Section 8 project-based programs.

-- The unit rents for some of the distressed properties we visited are equal to or higher than those of other properties in the same area whose physical condition and amenities are much better. Thus, the government is paying sizeable rent subsidies for poor quality housing.

-- HUD has various enforcement tools to ensure that owners maintain assisted properties in compliance with the housing quality standards--including administrative sanctions such as barring or suspending owners from further participation in Section 8 programs and terminating the housing assistance contract. However, HUD has used these tools sparingly and inconsistently. Poor management information systems and ineffective oversight of properties have seriously impeded HUD's ability to document problems and pursue enforcement actions. In addition, under current laws, if HUD applied the more severe enforcement penalties, (1) low-income tenants could be displaced and (2) the federal government could incur significant additional

costs, depending on the interpretation of laws requiring that properties continue to serve low-income tenants.

- Administrative and legislative initiatives are under way to help HUD overcome some of the impediments to dealing with properties in serious disrepair. However, HUD does not have an immediate plan of action for assisting tenants in the most severely distressed properties and for addressing the problems at each property. Moreover, because some of the initiatives that have been introduced have broader public policy implications, they require further analysis.

Before we discuss the results of our work in more detail, we will show a video tape depicting the conditions in some of the assisted properties we visited. Following the video tape, we will provide some background information on the Section 8 program and discuss further the results of our work.

BACKGROUND

HUD's Section 8 project-based rental assistance programs¹ were established under Section 8 of the United States Housing Act of 1937, as amended (42 U.S.C. 1437 et seq.). The subsidies provided under these programs allow about 1.5 million lower-income households to obtain housing from private owners. Households receiving this assistance must live in designated properties, and they are generally required to pay 30 percent of their income for rent. HUD generally enters into housing assistance payment contracts with the owners of the properties and provides rent subsidies to them. The subsidy represents the difference between the tenant's payment and the agreed-upon rent. Because these rent subsidies are attached to particular units, tenants who move lose their rental assistance unless they move to another subsidized unit.

¹Unlike tenant-based subsidies, project-based subsidies are attached to particular property units. The primary project-based assistance programs are (1) the Section 8 Property Disposition program, which provides assistance to ensure that properties acquired by HUD through foreclosure and eventually resold are maintained as low-income housing; (2) the Section 8 Loan Management Set-Aside program, which provides assistance to projects with HUD-insured and HUD-held mortgages that are experiencing immediate or potentially serious financial difficulties; and (3) the Section 8 New Construction and Substantial Rehabilitation programs, which provide assistance to private developers to construct new units or to substantially rehabilitate units for rental to low- and moderate-income families.

Although not the subject of today's testimony, two other types of tenant-based rental assistance--certificates and vouchers--are provided under HUD's Section 8 programs. An additional 1.3 million households use certificates or vouchers to obtain housing. Generally, these assisted households may use certificates and vouchers to rent from owners of their choice, provided the units meet HUD's requirements for rent levels and housing quality standards.

HUD's Section 8 project-based assistance programs are administered by the Office of Multifamily Housing Management, within the Office of the Assistant Secretary for Housing--Federal Housing Commissioner. To a large extent, HUD's field offices carry out the programs' activities under the direction of this office.

Two documents governing HUD and the property owners--the housing assistance payments contract and the regulatory agreement (for HUD-insured properties)--require owners to maintain assisted properties in good physical condition. Also, lenders providing mortgages for HUD-insured properties are required, in servicing their mortgages, to annually inspect the property and send copies of the inspection results to the local HUD field office, the property owner, and the management agent.

For HUD-insured and -assisted properties, HUD is required, as part of its loan servicing activities, to oversee project

owners, management agents, and lenders to ensure that Section 8 assisted properties are maintained in good physical condition.² According to the provisions of the housing assistance payments contract, HUD is required to have the units inspected at least annually to ensure that the property owners are complying with the housing quality standards. Inspections are to be conducted by HUD's field offices or contractors to (1) assess the performance of management agents in operating a project; (2) determine the condition of a property's buildings, grounds, and mechanical systems; and (3) look at the interiors of a sample of units to determine whether the units meet the housing quality standards. In addition, lenders with HUD- insured mortgages are required to inspect properties at least once a year and report to HUD.

CONDITIONS IN SOME HUD-ASSISTED PROPERTIES
VIOLATE HOUSING QUALITY STANDARDS

During our review, we found physical conditions ranging from very good to very poor in properties receiving Section 8 project-based assistance. Properties in good condition were well maintained throughout the interior and exterior of the buildings. Also, the tenants were afforded various services and amenities, such as child care and youth activities. However, the focus of our review was on properties in poor physical condition, so that we could obtain a perspective on the severity of the problems and

²In addition to HUD, public housing agencies and state housing finance agencies carry out loan servicing activities for some Section 8 assisted properties.

understand the factors that impede HUD from enforcing its housing quality standards.

HUD does not have complete information on the condition of the more than 20,000 properties that receive project-based assistance. In our review, we found properties in conditions far below HUD's housing quality standards. Nevertheless, some of these properties had rents that were equal to or greater than those at other properties in the same area. Thus, the federal government is paying large subsidies for poor quality housing.

Some Assisted Properties Are
in Poor Condition

Ten distressed properties, located in seven cities, are the focus of our testimony today. These 10 properties house over 1,200 families, cost the federal government about \$7 million in rent subsidies in 1993, and reflect conditions far below HUD's housing quality standards. (App. II summarizes the conditions in these 10 properties.)

Among the problems we found in the 10 distressed properties we visited were

- boarded-up units, some of which were easily accessible through unlocked front doors;

- missing kitchen cabinets, appliances that were not in proper working condition, and leaking toilets and sinks;
- inoperative air conditioners and inoperative or missing smoke detectors;
- exposed wiring and electrical outlets;
- evidence of roach and/or rodent infestation;
- poorly maintained walkways, stairs, common areas, and laundry rooms;
- inadequate exterior and interior lighting and other security problems such as holes in security fences; and
- interior ceilings, walls, and floors damaged by water leakage.

In reviewing HUD's inspection reports, we found that many of the problems we observed had been previously documented and, in some cases, were long-standing. For example:

- At Holiday Lake Apartments in Pompano Beach, Florida, HUD's Jacksonville Field Office noted significant physical deficiencies in the property's exterior and in many of the

units inspected in May 1993. Also, three inspections over the last year rated the property's overall physical condition and maintenance policies and practices as unsatisfactory. In the November 1993 inspection, for example, 114 out of 222 units inspected (51 percent) failed to meet the housing quality standards. Furthermore, in the March 1994 inspection, the field office found life-threatening problems, such as exposed 220 volt wires on outside air conditioning units.

-- At Edgewood Terrace Apartments in Washington, D.C., HUD's Washington, D.C., Field Office rated the property as unsatisfactory in overall management operations from 1989 through 1993. A November 1992 review stated that "many occupied and vacant units are unfit for human habitation" and described existing physical conditions as "deplorable." During a physical inspection conducted in January 1993, all of the units inspected failed to meet the housing quality standards. An architectural report prepared for HUD in July 1994 stated that the property required replacement of roofs, windows, heating/air conditioning units, kitchens, and bathroom components.

Large Subsidies Are Being Paid
for Poor Quality Housing

HUD is paying significant subsidies to house low-income families in the 10 properties we visited with serious physical problems. Table 1 provides data on the rents for these properties and the rents for well-maintained two-bedroom units in other properties in the same area.

Table 1: Unit Rent, Rental Income, and Subsidies for 10 Physically Distressed Properties

City/project	Unit rent ^a	Rent in neighboring buildings ^b	Rental income--calendar year 1993		
			Property's rental income	Section 8 subsidy	Subsidy as a percent of rental income
Washington, D.C.					
Edgewood Terrace	\$751	\$895-920	\$1,415,981	\$558,147	39
Skytower	734	550-600	788,595	638,344	81
New York, New York					
Unity ^c	1,138	600-750	880,680	681,829	77
De Diego Beekman IV	980	700-840	1,374,256	904,809	66
Chicago, Illinois					
6000 S. Indiana Apts.	849	435-475	413,736	270,553	65
Tyler, Texas					
Liberty Arms ^d	374	281-439 ^e	306,574	228,960	75
Pompano Beach, Florida					
Holiday Lake ^d	434	^f	943,610	647,556	69
Las Vegas, Nevada					
Sierra Nevada Arms	468	600	1,166,300	999,507	86
Carey Arms	820	380	2,479,712	1,823,000	74
Los Angeles, California					
Urban Rehab II	667	659 ^g	354,902	208,059	59

Note: Section 8 subsidies totaled about \$7 million for these 10 properties.

^aRent charged for a two-bedroom unit.

^bRent charged for a two-bedroom unit in a neighboring unsubsidized property.

^cRental income and Section 8 subsidy reported are for calendar year 1992.

^dRental income and Section 8 subsidy reported are for fiscal year 1993.

^eSince there are no unsubsidized properties in the area, the rent for a two-bedroom unit in a well-maintained subsidized property is used here.

^fThere are no subsidized or unsubsidized properties in the immediate area.

In 1993, HUD paid about \$7 million in subsidies for the 10 properties shown in table 1. These subsidies represent between 39 percent and 86 percent of the owners' total rental income from the properties. In five cases, the rents in these subsidized units exceeded those of well-maintained properties in the same area; in two cases they were comparable; in two cases they were below those rents; and in one case there was no other rental property in the immediate area. Furthermore, these other properties in the area offered residents amenities and services that were superior to those offered at the properties in disrepair. For example, one property in southeast Washington, D.C., offers day care facilities, a learning center, and a special summer program for young people in cooperation with the local police.

FACTORS IMPEDING HUD'S EFFECTIVE ENFORCEMENT
OF HOUSING QUALITY STANDARDS

HUD has a wide range of enforcement tools intended to ensure that its subsidized housing is maintained according to the housing quality standards. These tools, used correctly, can help to ensure that Section 8 assisted properties are well maintained, but they have certain limitations. In addition, certain factors have diminished HUD's ability to effectively use these tools to enforce the housing quality standards.

Enforcement Tools Range in Severity
but Have Certain Limitations

HUD's enforcement tools provide a wide range of penalties that the Department can apply if the owners of properties receiving Section 8 assistance do not comply with the housing quality standards. These tools range in their severity and impact. Among the least severe are various administrative sanctions that can limit the owners' or management agents' future participation in HUD programs. These sanctions are particularly effective with owners or management agents who want to continue to participate in HUD programs but are less useful when the parties are no longer interested in working with HUD.

Civil money penalties have potentially greater impact. Authorized by the HUD Reform Act of 1989, these penalties apply to violations of the regulatory agreement governing HUD-insured properties. Since the regulatory agreement stipulates that owners must maintain their properties in good repair, failure to do so is a clear violation. According to the law, HUD may assess a penalty of up to \$25,000 for each violation. However, there are three notable limitations to civil money penalties. First, under current law, these penalties are limited to the entity that owns the property, which in many cases is a partnership with few resources other than the insured property. Thus, any money penalty may have a limited effect. Second, civil money penalties only apply to owners of Section 8 assisted properties whose mortgages are

insured by HUD. Finally, identity-of-interest management companies³ are not covered by civil money penalties.

Among the most severe penalties HUD can apply are (1) suspending Section 8 assistance for individual units in a property that do not comply with the housing quality standards and (2) terminating the housing assistance payments contract in cases in which a property has a history of serious physical neglect. Either action can have serious repercussions for tenants and a property's financial viability. At present, HUD generally does not have the funding to provide tenants with long-term alternative housing assistance if they are displaced from a property receiving Section 8 project-based assistance. However, according to the terms of the housing assistance payments contract, HUD can use the suspended Section 8 assistance payment to temporarily rehouse the tenants in other units. Aside from the effect on the tenants, suspension or termination of Section 8 assistance would directly affect a property's cash flow. As a result, these actions are likely to be effective with owners who wish to retain their properties but less effective with owners of properties that are no longer profitable.

³An identity-of-interest management company is one in which the owner of a property also has an ownership interest in the management company.

Problems in HUD's Data Systems and Loan
Servicing Impede Use of Enforcement Tools

Because of limitations in its capacity, HUD has been impeded in its ability to adequately oversee its assisted properties and take appropriate action when conditions warrant it. These limitations center on poor management information systems and a lack of staff capacity to perform effective loan servicing.

More specifically, HUD's ability to routinely identify and monitor properties in deteriorating physical condition--and thus to initiate appropriate enforcement actions--is impaired because the Department's information systems do not contain the data necessary to do so. Although the information systems in HUD's field offices contain data from physical inspection reports, the systems do not (1) contain data on, or reflect, the number of units in each property that do not meet HUD's standards for safe and decent housing or (2) track the actions taken to address problem conditions.

Unstable financial conditions in a property, if left unresolved, can also contribute to deterioration of the property's physical condition and possibly warrant enforcement penalties if the financial problems can be attributed to abuses by the owners. However, HUD's financial systems, which support oversight of the inventory of assisted properties, have been so deficient that they have been (1) classified as part of a material internal control

weakness in loan servicing, under the Federal Managers' Financial Integrity Act, since 1987 and (2) cited as not containing adequate data to provide early warning of deteriorating financial conditions in the properties.

In addition to problems with the information systems, problems with loan servicing also affect HUD's performance in enforcing compliance with the housing quality standards. For example, field offices, as part of their loan servicing activities, perform physical inspections, review financial statements, and conduct on-site management reviews of HUD-insured and Section 8 assisted properties. However, in an April 1993 report on six field offices, HUD's Office of Inspector General stated that such reviews were not conducted in a manner that would consistently identify substandard living conditions.⁴

The Inspector General's report was one of over a dozen audit reports, studies, task forces, and management reviews over the last two decades that have identified long-standing problems with HUD's loan servicing activities. These problems included heavy staff workloads, the incomplete training of loan servicers, and poor supervision and oversight of the loan servicing function. Without

⁴Multi-Region Audit of HUD's Servicing of Insured Multifamily Projects, U.S. Department of Housing and Urban Development, Office of Inspector General, 93-HQ111-0014 (Washington, D.C.: Apr. 30, 1993).

effective oversight of properties, HUD is not in a position to effectively enforce its housing quality standards.

Other Factors Further
Impede Enforcement Actions

HUD has the authority to terminate Section 8 assistance in all units in properties that are in very serious disrepair. However, it has rarely taken this action. Furthermore, depending on how current laws are interpreted, doing so could create a new set of problems, some of which may be costly.

First, under appropriations law, if Section 8 funds for a property are terminated, these "recaptured" funds must be returned to the Treasury and cannot be reused by HUD to relocate tenants in decent housing in the community. Thus, removing Section 8 assistance from a run-down property could, unless other funding were available, result in the displacement of families.

Second, if HUD attempts to acquire a distressed property in order to improve its physical condition, it may meet resistance from the current owners because of the tax consequences. Specifically, under current tax law, owners may be required to pay a significant tax even if they receive no cash from the sale of the property. This tax, known as an "exit tax," is often associated with older properties that have been significantly depreciated.

Finally, if HUD were to apply its most severe enforcement penalty--termination of the Section 8 contract on an insured property--foreclosure proceedings could result in HUD's becoming the property owner. Depending on how the recently enacted provisions of federal "preservation" laws are interpreted, HUD may be required, if it disposes of any units receiving project-based assistance, to replace them with new assisted units. Consequently, even if the appropriations law were changed to give HUD the authority to reuse recaptured Section 8 funds to relocate tenants in decent housing in the community, HUD might need roughly an equivalent amount of additional budget authority to sell a distressed property.

SOME CORRECTIVE INITIATIVES ARE UNDER WAY,
BUT IMMEDIATE ATTENTION IS NEEDED FOR SEVERELY
DISTRESSED PROPERTIES

HUD is taking steps to improve its information systems and loan servicing activities, and legislation has been introduced in the Congress to assist HUD in overcoming certain impediments to dealing with properties in very poor physical condition. While these actions are a step in the right direction, they do not resolve the immediate problems facing tenants living in the most severely distressed Section 8 assisted housing.

HUD's Actions to Improve Its Oversight
of Properties Do Not Address
the Immediate Needs of Tenants

HUD is making an effort to identify the information needed to provide proper oversight of the physical condition of its assisted properties and to take steps to collect this information. Likewise, to address weaknesses in its financial systems, HUD is developing a national system that it expects to contain an early warning component to help identify properties with potential problems. According to HUD officials, 75 percent of the 1993 financial statements for assisted properties have been entered into the system, and the Department has begun to analyze a portion of them. Finally, HUD is trying to improve its loan servicing performance, in part through the use of contractor personnel to conduct physical inspections of the assisted properties.

These are all positive initiatives which, if carried out effectively, should place HUD in a better position to manage its inventory of assisted properties and take appropriate action if the physical condition of any properties begins to decline. However, there are some issues in the implementation of these initiatives that need to be addressed, and immediate action is needed to assist tenants living in the most severely distressed properties.

First, as we noted earlier, HUD has experienced long-standing problems with its information systems, and reports by HUD's

Inspector General have for years pointed to deficiencies in HUD's capacity to effectively service its inventory of assisted properties. Although HUD is taking action to correct these problems, it will likely take a number of years to resolve them.

Second, while we did not assess the quality of property inspections performed by outside contractors, staff in some HUD field offices expressed concerns about this issue. For example, one field office told us that it had required a contractor to redo 9 of its first 11 inspections because the inspections were considered inadequate. In addition, an owner provided us with documentation showing that although his property was inspected by a contractor in August 1993, he did not receive the report from HUD until April 1994. This delay diminished the report's utility.

Third, as noted earlier, lenders with HUD-insured Section 8 assisted properties are required to inspect these properties at least once a year and send a copy of the report to HUD. Staff at some of the HUD field offices we visited said they relied on lenders' inspections because the field offices lacked sufficient staff of their own. However, the staff considered these inspections generally unreliable in documenting the actual physical condition of the properties.

Finally, although HUD is taking actions on selected distressed properties, including some of those we visited, it has not

developed a comprehensive strategy for promptly identifying and dealing with the severely distressed Section 8 assisted properties in its inventory.

Legislation Has Been Proposed to Increase
HUD's Flexibility on Distressed Properties

Legislative proposals have been introduced that would provide HUD with additional flexibility in dealing with assisted properties in very poor physical condition. While these initiatives are designed to address specific problems that HUD faces with distressed properties, some raise other issues when they are considered in the context of existing laws.

Three key initiatives are being considered. Senate Bill 2049 provides for (1) the reuse of recaptured Section 8 project-based assistance and (2) an expansion of civil money penalties. Senate Bill 1986 and House Bill 3322 provide for tax relief for owners of troubled properties.

Under one provision in Senate Bill 2049, HUD would be allowed to reuse Section 8 project-based assistance, recaptured when housing assistance payments contracts are terminated, to relocate tenants currently living in distressed properties. The bill provides HUD with the choice of relocating tenants using either certificates or vouchers or providing alternative Section 8 project-based housing. HUD supports this provision because it

provides a means to protect tenants who might be displaced if HUD terminates the Section 8 housing assistance payments contract for a property. In concept, we also support this provision. However, as we pointed out earlier, depending on how this provision is interpreted, it could, under the current preservation laws, increase both the total number of subsidized units and the subsidies required to support them.

Senate Bill 2049 would also expand the application of civil money penalties to include all Section 8 project-based assisted properties, not just those currently insured by HUD. This bill allows civil money penalties to be imposed on owners, general partners, and identity of-interest management companies. Although HUD has no overall statistics on the results of applying civil money penalties, Department officials cited instances in which these penalties have been successfully used to get owners to remedy problems. However, these officials would like to be able to apply these penalties to all Section 8 assisted properties and directly to general partners and/or identity-of-interest management companies. Although we have not analyzed this option in any detail, we support the principle of giving HUD added flexibility in dealing with owners of distressed properties.

To address the problems associated with "exit taxes," Senate Bill 1986 and House Bill 3322 propose to amend the tax code to relieve current owners of part of their tax liability when they

sell their properties. If the current tax disincentive to sell were removed, some owners of severely distressed properties might be replaced with new owners who have the financial incentive and means to improve the physical condition of the properties. We should point out, however, that the level of the exit tax that owners are subject to varies widely among physically distressed properties. For example, for one property we reviewed, the exit tax would be negligible; for another property, the tax could exceed \$5 million. Without further analysis, it is not clear to what extent the provisions of Senate Bill 1986 and House Bill 3322 would assist HUD in getting new owners for distressed properties nor whether this policy would be the most economically efficient or equitable way to accomplish this purpose.

CONCLUSIONS

Section 8 project-based assistance is providing low-income tenants with decent, safe, and sanitary housing. However, this assistance is sometimes providing tenants with inferior housing at a substantial cost to the federal government.

In the current budgetary climate, all federal agencies are forced to consider the cost implications of their policy decisions. With limited funding, HUD needs to make cost-effective choices to address distressed housing. However, hampered by inadequate information systems and long-standing problems in its loan

servicing, HUD cannot (1) accurately report on the condition of its inventory of Section 8 project-based assisted properties or (2) make the appropriate economic choices. The lack of information also impedes HUD from initiating prompt enforcement actions to address serious violations of its housing quality standards.

Further complicating HUD's problems is the Department's lack of authority to reuse funds recaptured from terminated Section 8 contracts to relocate tenants from severely distressed properties to other properties of higher quality. Even if new legislation gave HUD the flexibility to relocate tenants from a distressed property, the Department could, depending on how current preservation laws are interpreted, still incur significant additional costs for preserving the property.

HUD has taken steps to begin dealing with its problem properties, such as identifying the information needed to provide proper oversight of the physical condition of its assisted properties and addressing weaknesses in its financial systems. The legislation that has been introduced would complement these initiatives. Nevertheless, these initiatives have not been pulled together into the kind of comprehensive strategy necessary to best ensure (1) a prompt remedy for tenants living in the most deplorable conditions and (2) effective oversight to minimize future occurrences of, and costs associated with, distressed properties. In the absence of a strategy that focuses priority on

the most severely distressed properties and a clear assessment for the Congress of HUD's resource and legislative needs, tenants may continue to live in the conditions we have described, at a considerable cost to the federal government.

RECOMMENDATIONS TO THE SECRETARY OF HUD

We recommend that the Secretary of HUD begin immediately to develop a comprehensive strategy to address the very poor physical conditions under which some families supported by Section 8 project-based assistance are living. As part of this strategy, HUD should, through the use of its field staff (1) promptly identify all Section 8 assisted properties with severe physical problems and offer affected tenants temporary assistance to relocate to safe and decent housing, (2) systematically notify owners of the problems identified, and (3) take appropriate enforcement actions in cases in which owners do not bring their properties into compliance with the housing quality standards. To the extent that budgetary or legislative constraints prevent HUD from addressing these conditions, we further recommend that the Secretary provide the Congress with an assessment of the resources and legislative changes the Department needs.

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Mr. Chairman, the focus of our testimony today has been on some of the more severely distressed Section 8 project-based assisted properties and the need for HUD to take immediate action to improve the living conditions of tenants in these and other similarly distressed properties. However, HUD's effectiveness in dealing with these conditions and minimizing similar situations in the future will depend on the Department's (1) building the capacity necessary to manage its large inventory of assisted properties and (2) identifying and successfully working with the Congress and the Office and Management and Budget on the budgetary and legislative issues related to this matter.

APPENDIX I

APPENDIX I

PROPERTIES DEPICTED IN THE TESTIMONY AND VIDEO TAPEDISTRESSED PROPERTIESWashington, D.C.

Edgewood Terrace Apartments
601 Edgewood Terrace, NE
Washington, DC 20017

Skytower Apartments
1045 Wahler Place, SE
Washington, DC 20032

New York

Unity Apartments (consists of two buildings)
1545 St. John's Place
Brooklyn, New York 11213

and

260 Buffalo Avenue
Brooklyn, New York 11213

Jose de Diego Beekman IV Apartments
637-639 East 140th Street
Bronx, New York 10454

Illinois

6000 South Indiana Apartments
6000 South Indiana Avenue
Chicago, Illinois 60616

Texas

Liberty Arms Apartments
2601 North Broadway Avenue
Tyler, Texas 75702

APPENDIX I

APPENDIX I

Florida

Holiday Lake Apartments
831 North Powerline Road
Pompano Beach, Florida 33069

Nevada

Sierra Nevada Arms Apartments
1971 Carrara Street
Las Vegas, Nevada 89106

Carey Arms Apartments
2417 Morton Street
North Las Vegas, Nevada 89030

California

Urban Rehab II Apartments
11605 South Avalon Street
Los Angeles, California 90071

WELL MAINTAINED PROPERTIESWashington, D.C.

Atlantic Gardens
4319 3rd Street, SE
Washington, DC 20032

Florida

Driftwood Terrace
3146 North West 19th Street
Ft. Lauderdale, Florida 33311

PHYSICAL CONDITION OF 10 DISTRESSED PROPERTIES GAO VISITED

This appendix describes the physical condition of the ten properties we visited.

Edgewood Terrace Apartments (Washington, D.C.)

Edgewood Terrace Apartments, located in northeast Washington, D.C., is a 292-unit complex consisting of one 8-story mid-rise building and three 3-story garden apartment buildings. The property was sold to its current owners in 1983. The current owners have defaulted on the mortgage, which HUD now holds. At the time of our inspection in June 1994, 114 units were occupied and 178 were vacant. In 1993, this property received \$558,000 in Section 8 project-based assistance. A two-bedroom apartment in this complex rents for \$751 a month. The monthly rent for a two-bedroom apartment in a neighboring unsubsidized property in good physical condition is \$895 to \$920.

In 1992, a nonprofit organization, interested in purchasing this property, assessed the capital needed and identified repair expenses in excess of \$23 million. More recently, after HUD became the mortgagee in possession, the Department conducted a needs assessment and concluded that the property could be repaired for about \$10 million. Regardless of the total costs, according to

inspection reports that were verified in part by our own on-site inspection, the project will require replacement of roofing, windows, kitchens, and components of bathrooms and heating and air conditioning systems within each apartment. Also, the elevators must be upgraded to meet building codes, and the boilers need repair or replacement.

During our visit to the property, we also observed a collapsed parking garage and exterior grounds in serious disrepair, including play areas, benches, sidewalks, stairways, and general landscaping. In addition, we found buildings with filthy and poorly lit hallways and common laundry areas. There were marked differences in the condition of individual units. A unit in the mid-rise building, for example, was in very good condition except for a malfunctioning air conditioner and some molding missing from the kitchen counter. On the other extreme, some units had broken kitchen cabinets; missing security locks; water damage from a leaking roof; insect infestation; and, according to some tenants, a serious rodent problem.

Skytower Apartments (Washington, D.C.)

Skytower Apartments, located in southeast Washington, D.C., is a 91-unit complex consisting of 10 buildings. Nine of the 10 garden-style buildings have three floors and one has four floors.

APPENDIX II

APPENDIX II

Individual units range in size from one to six bedrooms. At present, five units are vacant and the remaining 86 are occupied. In 1993, this complex received \$638,344 in Section 8 project-based assistance. A two-bedroom apartment in this complex rents for \$734 a month. The monthly rent for a two-bedroom apartment in a neighboring unsubsidized property in good physical condition is \$550 to \$600.

In 1993, both a comprehensive management review and a physical inspection, which found 20 units below HUD's housing quality standards, rated the property as "unsatisfactory." Moreover, during a reinspection of housing quality standards conducted from May 27 to June 3, 1994, Skytower Apartments was again rated as unsatisfactory. According to the inspection report's findings, which were verified in part by our own on-site inspection, lawns in common areas were almost completely bare with noticeable erosion; all emergency lights, exit lights, and fire extinguishers were missing; all 10 buildings required drywall repair and paint; and all 10 buildings had inoperative air conditioning systems--some systems have not worked for years.

In our on-site inspection of several units, we also noticed ceilings and walls with evidence of water leaks, kitchen and bathroom areas in poor condition, and laundry rooms chained and off limits to tenants. We also observed a significant insect problem,

and tenants told us they kept cats to combat a worsening infestation of rats.

Holiday Lake Apartments (Pompano Beach, Florida)

Holiday Lake Apartments, located in Pompano Beach, Florida, is a 232-unit complex consisting of 16 two-story and three-story buildings. The original owner died in 1992, and his brother became the property's owner. Currently, 185 units receive Section 8 project-based assistance and 31 units are vacant. In 1993, this property received \$648,000 in Section 8 project-based assistance. A two-bedroom apartment in this complex rents for \$434 a month. There are no other subsidized or unsubsidized rental properties in the vicinity of this complex, so we could not compare rents.

HUD's Jacksonville Field Office became aware of the poor condition of this property in May of 1993, when a management review rated the overall management operations as unsatisfactory. Since 1993, the field office has conducted three comprehensive physical inspections, all resulting in unsatisfactory ratings. In the June 1993 inspection report, the inspector concluded that \$546,205 was needed to repair the property's physical deficiencies, which included poorly maintained grounds and inoperative exterior lighting and smoke detectors. Although some of the physical deficiencies have been corrected since that time, according to

APPENDIX II

APPENDIX II

HUD's documents, the property still has serious physical problems, as we observed during our visit in June 1994.

Our observations confirmed many of the same physical problems that were reported in HUD physical inspections over the last year. These problems included missing kitchen cabinets and doors, large holes in walls and floors, unstable toilets and sinks, roach infestation, water damage in rooms from outside leaks, and unkempt grounds.

Unity Apartments (New York, New York)

Unity Apartments, located in the East New York section of Brooklyn, New York, is an 83-unit project consisting of two mid-rise buildings about a block apart. Currently, two units are vacant. It has been owned and managed by the same partners since it was developed. In 1992, the property received about \$682,000 in Section 8 project-based assistance.⁵ A two-bedroom apartment at Unity rents for \$1,138. In contrast, the rent for a two-bedroom unit in an well-maintained unsubsidized property in the same general area is between \$600 and \$750 per month.

⁵The assistance amount for 1992 was used because complete data for 1993 were not available.

HUD's New York Field Office has classified Unity Apartments as a "potentially troubled" property both because of its physical condition and for financial reasons. The field office's most recent inspections of this property indicated, among other things, electrical and plumbing problems, inoperative fire alarm and intercom systems, broken boilers and elevators, flaking exterior walls, and seriously deteriorated windows. According to the field office's estimates, it will cost \$149,000 to repair these and other problems. Financial statements filed by the owner in 1991 and 1992 show that the property has also sustained large operating losses over the last several years.

While the management company has usually responded to HUD's inspection findings by indicating that deficiencies have been corrected, our visit in late June showed continuing physical deterioration. The problems we noted included an inoperative fire alarm system (HUD had made the same finding), a vandalized laundry room, a missing entrance door and window, graffiti inside and outside, a broken elevator, and a security system that tenants told us had not worked for years. The HUD inspector we talked to said the property had not improved over the 6 years that he has been inspecting it.

Jose de Diego Beekman IV Apartments (New York, New York)

De Diego Beekman IV Apartments, located in the Mott Haven section of the Bronx, New York, is a 134-unit complex consisting of five separate buildings on several streets. Beekman IV is one component of a larger Beekman Houses property, which contains more than 1,100 apartments in 38 buildings that were renovated in different phases during the 1970s. According to the property's June 1994 vacancy report, Beekman IV had two vacant apartments. All of the apartments are subsidized with Section 8 project-based assistance. In 1993, the property received \$904,809 in Section 8 project-based assistance. A two-bedroom apartment rents for \$980; according to several local real estate brokers, the monthly rent for a two-bedroom unit in a well-maintained unsubsidized property in the same area ranges from \$700 to \$840.

HUD's New York Field Office has classified Beekman IV and other components of Beekman Houses as "troubled" properties. Inspection reports show a long history of inadequate repair practices, including major problems with the roofs of numerous buildings. An inspection in January 1994 resulted in a "below average" rating for the Beekman IV building because of broken elevators, rat and mice infestation, leaking sewage, roof leaks, and other deficiencies.

During our visit at the end of June 1994, it appeared that the project's management had taken actions to correct some deficiencies; for example, repair and replacement of roofs had occurred. However, there are still extensive graffiti inside and outside the buildings, broken doors and windows, and elevators that are unreliable at best. One factor working against the correction effort, however, is the high level of vandalism and illegal drug activity in the neighborhood. The project manager said it is a constant struggle to replace doors, windows, and locks that are frequently broken or stolen. To curb some of the vandalism and illegal activity, the management company uses a corps of building monitors to patrol common areas and report incidents to the police.

6000 South Indiana Apartments (Chicago, Illinois)

6000 South Indiana Apartments, located on the south side of Chicago, Illinois, is a 70-unit, 12-story, high-rise building. At present, 13 units are vacant and 68 units receive Section 8 project-based assistance. In 1993, the property received \$270,553 in assistance. The monthly rent for a two-bedroom apartment is \$849. According to local real estate agents, the monthly rent for a two-bedroom unit in well-maintained unsubsidized properties in the same area ranges from \$435 to \$475. In 1988, the owner of 6000 South Indiana Apartments defaulted on the mortgage, which HUD now holds.

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This property has been rated as unsatisfactory in four physical inspections conducted by HUD's Chicago Field Office since 1989. In 1991, 18 apartments were inspected and all failed to meet HUD's housing quality standards. The 1993 inspection report noted that the building would require over \$933,000 in repairs. These repairs would include entirely replacing--in all units--all kitchen fixtures and appliances, windows, and floor tiles and, in bathrooms, replacing medicine cabinets, lighting, and plumbing fixtures. In addition, the inspection report noted that exterior and common areas needed extensive repair. Many of the findings involved safety items such as elevators, emergency lights, and smoke detectors. Under a 1994 HUD-approved management improvement plan, \$910,000 worth of repairs are scheduled, to be paid for with revenues from a recent rent increase. HUD has also awarded the building a \$175,000 drug elimination grant to address physical security deficiencies and provide drug counseling to tenants. HUD did not require the owner to contribute to the repair costs.

Our visit to this property verified the physical conditions noted in the field office's inspection reports. We also discovered additional safety violations, such as missing hallway fire doors and unlit emergency stairways. The building is under new management, and we observed one apartment in relatively good shape, except that the new kitchen cabinets and sinks that have been ordered for all apartments were not yet installed. On the other

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extreme, we observed some units with large holes in the walls caused by water leaking through the roof and from broken plumbing fixtures. One hole in a tenant's bathroom opened into the building's garbage room, giving insects, rats, and mice direct access into this inhabited apartment. Indeed, several tenants complained of rat and mice infestation. We also observed kitchen cabinets falling apart, missing floor tiles in almost every room, and a broken elevator (one of two in this 12-story building). We learned that this elevator had been broken for 3 months.

Liberty Arms Apartments (Tyler, Texas)

Liberty Arms Apartments is located in Tyler, Texas, about 100 miles east of Dallas. A 100-unit complex, it consists of eight 2-story garden apartment buildings. At present, 20 of the 100 units are vacant. In 1993, this property received \$228,960 in Section 8 project-based assistance. The monthly rent for a two-bedroom unit is \$374. While there is no unsubsidized housing in the same neighborhood or area of town, neighboring subsidized apartment complexes in good condition charge between \$281 and \$439 a month for a two-bedroom unit. The owners of the Liberty Arms Apartments are current on their mortgage now but have been delinquent on several occasions in the past.

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In June 1994 management review and physical inspection reports, HUD's Dallas Field Office identified repair expenses in excess of \$655,000. According to these reports, this apartment complex will require the replacement of roofing, windows, siding, plumbing, electrical fixtures, and floor coverings, and at least a third of the property's units will need replacement ranges, refrigerators, countertops, cabinets, and sheetrock. The reports also estimated that it will take at least an additional \$100,000 to repair the air conditioning system, and it could well cost many times this amount. The inspection report concluded that all units in this complex are in unsatisfactory condition and that the 20 vacant units are uninhabitable. Overall, this property was considered a health and safety risk to all its residents.

Aside from those problems that the field office staff reported, our visit to the property revealed exterior grounds in serious need of improvement--including play areas, sidewalks, stairways, and general landscaping. Furthermore, the exterior of the buildings had rotted siding, rusted stairs, and broken light fixtures. Most of the individual units we observed were in very poor condition. For example, one unit had damage to ceiling and floor tiles throughout the premises, holes in the ceilings of both bathrooms, a continuously running toilet, and serious insect infestation.

Urban Rehab II Apartments (Los Angeles, California)

Urban Rehab II Apartments, located in south central Los Angeles, consists of six 2-story buildings with 48 two-bedroom units. Currently, all units are occupied. In 1993, this property received \$208,059 in Section 8 project-based assistance. A two-bedroom apartment rents for \$667 a month. While there is no unsubsidized housing in this area of the city, a neighboring subsidized complex in better physical condition charges \$659 a month for a two-bedroom unit.

Physical inspections and management reviews conducted by HUD's Los Angeles Field Office have rated this property as unsatisfactory since 1990. Urban Rehab II Apartments has been a continual problem for the field office, and tenants have filed numerous complaints about its deplorable physical condition. The property's documented physical problems include inadequate exterior security, termite infestation in the balconies of upper units, and serious disrepair in the landscaping. Individual units had visible signs of roach, rat, and mice infestation.

During our visit to the property, we noted that exhaust fans were missing in kitchens and observed signs of leakage in interior bathrooms and kitchen ceilings, bullet holes through kitchen windows, torn linoleum and carpeting throughout the units, and

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inoperative smoke alarms. None of the units had working air conditioning. In addition, this property is located in a high-crime district where theft, vandalism, and graffiti are constant problems. Because of the vandals and thieves, the laundry room on the site has been closed off and is no longer in use.

Carey Arms Apartments (Las Vegas, Nevada)

Carey Arms Apartments, located in north Las Vegas, Nevada, is a 289-unit complex consisting of 72 two-story buildings. Currently, 77 units are vacant. In 1993, the property received \$1,823,000 in Section 8 project-based assistance. A two-bedroom unit rents for \$820 a month. Rent for a two-bedroom unit in a well-maintained unsubsidized project in the same vicinity is \$380 a month. Since January 1991, the owners have not made a mortgage payment. HUD currently holds the mortgage and is now foreclosing.

Physical inspections and management reviews conducted by HUD's Las Vegas Field Office have rated this property as below average or unsatisfactory for the past several years. Many of the vacant apartments are in such poor condition that the management company is considering demolishing them. The last physical inspection report, dated October 1993, indicated the property was in need of repairs and maintenance estimated to cost \$3,055,603. Problems cited in this report include dysfunctional and defective irrigation

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and sewer systems, missing or damaged appliances in the vacant units, defective heating and air conditioning systems, termite and roach infestations, and a high degree of crime-related activities.

During our visit we observed inoperative smoke alarms, garbage disposals, and kitchen and bath exhaust fans; water damage and leaks from kitchen and bathroom plumbing; and torn and soiled carpeting. Exterior walls and sidewalks were covered with graffiti, buildings and fences were in need of paint, pot holes and loose gravel littered the parking lots, and eight units had been severely damaged by fire.

Sierra Nevada Arms Apartments (Las Vegas, Nevada)

Sierra Nevada Arms Apartments, located in north Las Vegas, Nevada, is a 352-unit complex consisting of 82 two-story buildings. Currently, 113 units are vacant. In 1993, this property received \$999,507 in Section 8 project-based assistance. A two-bedroom unit in this apartment complex rents for \$468 a month. The rent for a two-bedroom unit in a well-maintained unsubsidized property in the same vicinity is \$600 a month.

According to officials in HUD's Las Vegas Field Office, Sierra Nevada Arms Apartments is the worst project the office manages. Physical and financial problems with this complex have been long-

standing, principally because of the owners' inability to accumulate a reserve large enough to deal with all the needed repairs. While the owners are behind in their mortgage payments, they are not yet technically in default. HUD has proposed barring the owners from further participation in the Section 8 project-based assistance programs because of their negligence at Sierra Nevada Arms and because they maintain Section 8 properties in substandard condition throughout the country.

Physical inspections and management reviews conducted by the field office have rated this property as below average or unsatisfactory for several years. According to these reviews, the property is located in a high-crime area, and many vacant units have had kitchen appliances, bathroom fixtures, air conditioning and heating units, and electrical fixtures stripped or cannibalized. Problems in the occupied units noted in the reviews included inoperative appliances, heating systems, air conditioning systems, bathroom exhaust fans, and kitchen exhaust fans; plumbing leaks; and visible signs of insect infestation.

Our on-site inspection of this property revealed interior units with soiled, stained, and torn carpet and linoleum; inoperative appliances, smoke alarms, air conditioning, and heating systems; damaged kitchen cabinets with loose and missing drawers; severely damaged bathroom vanity tops and commodes; missing closet

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doors; torn and missing window screens; filthy walls; leaking toilets, bathtubs and sinks; and roach, rat and mice infestation. Our inspection of the project's exterior revealed faulty sprinkler systems with numerous leaks causing flooding throughout the grounds. We found that many vacant units were missing doors, windows, and screens. Moreover, the laundry room was filthy and in poor condition, with extensive graffiti and garbage strewn throughout.

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Mr. PETERSON. Thank you very much. We want to commend you for the fine work you have done on this report.

Ms. ENGLAND-JOSEPH. Thank you.

Mr. PETERSON. And rest assured we will be working with you to figure out where we head from here.

Next, we are going to have Susan Gaffney. Welcome back to the committee. As you know she is the Inspector General at HUD. We look forward to your testimony. Your full statement will be included in the record.

STATEMENT OF SUSAN GAFFNEY, INSPECTOR GENERAL, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, ACCOMPANIED BY CHRIS GREER, ASSISTANT INSPECTOR GENERAL FOR AUDIT

Ms. GAFFNEY. Thank you, Mr. Chairman, members of the subcommittee. You asked that the Office of the Inspector General report to you on two primary issues: one, the overall condition of project-based Section 8 properties and, two, whether there are issues pertaining to excessive rent levels in those properties.

With respect to the condition of the properties, I think perhaps the most authoritative study that has been done of that subject resulted from the HUD Reform Act of 1989. HUD, pursuant to that law, issued a report last September. The report looked at 13,000 insured properties, 10,000 of which were assisted. It found that 23 percent of the properties were distressed, distressed to the point where the well-being of the tenants was in jeopardy and the projects faced financial failure. The study found another 15 percent were stressed; that is, having conditions that, if not remedied within a short period of time, would cause the properties to fall into the distressed category. So we are dealing generally, based on that study, with a universe of 38 percent of these properties in a troubled condition.

Generally, our view from the Office of Inspector General is that at least 30 percent of these properties are in troubled status. Now, I will tell you a little about the work that we have done ourselves. We have found very severe problems. For instance, in 1990 we looked at 15 property disposition projects in the Cincinnati area. Our inspectors failed 95 percent of the units we inspected.

Also, in April 1993, the Office of Inspector General issued a major report on loan servicing by HUD throughout the country. We looked at 28 troubled multifamily projects and found that 82 percent of them had substandard physical conditions. We also found, as Ms. England-Joseph reported to you, that many of these conditions had existed over extended periods of time.

Now, the question is why, why do these conditions exist? And Mr. Chairman, as you said, these are not new conditions. They have come about over a lengthy period of time, but I would say to you also that the Office of Inspector General has for many years been telling you that there are three systemic problems in HUD that adversely affect everything that HUD does, and that is particularly true in this area of multifamily programs.

First is staffing problems. Price Waterhouse, in its audit of FHA financial statements, said look what is going on. If you want a

graphic illustration of inadequate staffing resources, a loan servicer in a State housing finance agency is responsible for about 20 loans.

Our typical loan servicer in HUD is responsible for 50 loans, and in some cases our loan servicers are responsible for as many as 73 loans. I ask you to consider whether it is reasonable, with 73 loans on your plate, that you are going to be able to do much about servicing those loans.

There is also, and I am sure Mr. Retsinas will speak to you about this in terms of staffing, a severe problem in expertise. We do not have the expertise in asset management generally that we need in HUD. We don't need bureaucrats, we need housing specialists who really know how to manage and get problems resolved.

About this staffing problem which we keep talking about. We keep talking about it. We, the OIG, keep talking about it and talking about it, and nothing happens except that staffing goes down every year. So, I think we are going to stop talking about FTEs, since it gets us nowhere, and we want to talk to you and the Office of Housing now about contracting. If you can't get the resources through FTEs, then we urge that Housing go out and procure those resources. We do that with full recognition that contracting is a very expensive alternative, but this situation should not continue.

The second area that adversely affects our performance in this program is data systems. FHA really doesn't have good data systems. Now, they are making progress. CFS TRACS, which is the basic system that you have all heard about, is moving along. It will take a long time. The management information system for FHA is much further beyond us. That management information system is so critical because it should be telling us where our properties stand in terms of financial condition and in terms of physical condition. You will have to ask Mr. Retsinas if he even now has a projected date when we will have an integrated system that will provide us those data.

The third area of weakness in HUD that affects this program is management controls. In our 1993 audit of loan servicing, we found that field offices were not consistently doing physical property inspections and were not consistently doing financial statement reviews. Onsite management reviews were not necessarily identifying problems, and, more importantly, they weren't leading to the resolution of those problems identified.

This kind of situation, when these properties are insured, leads to defaults and claims against the FHA insurance fund. I would point out to you that this is serious business: in 1993, the insurance claims totaled about \$1 billion for such properties.

Now, Mr. Retsinas can talk to you about the actions that he has under way. He and Ms. Dunlap have a lot of actions under way. They have recognized all of these problems, and they are acting on them. But their solutions are long term; the problems are not going to be solved overnight. It is going to be a matter of years.

Now, the question is, to me, what do you do in the meantime? And that is why I want to talk to you in terms of the management environment at HUD. I want to talk to you about the lack of program enforcement. There is a view at HUD that we are essentially a social service agency. What we are about is helping poor people.

The thinking is that if we take enforcement actions, that will inevitably lead to one of many negative conclusions.

For instance, if we declare a default, it results in a claim on the insurance fund. Until now, if we recaptured a Section 8 contract, the tenants in the project-based property would be left with no housing that they could afford. If we abated the Section 8 payments, so the thinking goes, what would happen? The owner would lose income needed to maintain the property, the property would further deteriorate, and who would suffer? The tenants.

The thinking is generally we can't do much of anything without hurting people that we don't want to hurt, whether it is the insurance fund or the tenants. Against this background, the IG has launched a major effort to try to do something about what is called equity skimming in multifamily insured projects. This is essentially when owners take out project revenues and assets for their own personal uses in violation of the regulatory agreement.

We have in the last few months identified some 120 cases of potential equity skimming. We have referred 70 of them to U.S. attorneys and 50 of those cases have been accepted for prosecution. This is a major effort on our part. I don't think it is enough. I think we need an equivalent investment by HUD management in enforcement activities.

Now, HUD has proposed and there is legislation now being considered that would do a lot to help our enforcement activities. There is legislation that, if we cancel the Section 8 project, would allow us to recapture those funds and use them again. There are legislative proposals on the table that would expand the provisions of civil money penalties and the provisions of the equity skimming statute.

We think legislation could go further; we think that the Congress should be looking further with respect to insured multifamily projects. You should be looking at the fact that many of these owners have put virtually no equity into these projects, which means they have very little to lose. You should look at the fact that this is nonrecourse debt, which means you can't go at the owners on a personal basis.

All of that legislation would be good. We support it. But, again, you are probably talking about a period of years until you get the legislation and we get implementing regulations. I think we need some immediate action, enforcement action by HUD.

Our premise in the Office of Inspector General is that you can send a message. You don't have to solve every problem, but if you target some of these properties and you go at them one by one and devise appropriate enforcement actions—there is not one answer for all of these properties—we believe that HUD could send a major message.

Now, I agree with GAO. I am not interested in strategies, I am not talking about plans. I am talking about HUD's actually taking affirmative action against some of these owners, and I say to you that we would probably have to do so with some risk that some people who don't deserve to be hurt may be hurt in the process.

It is for this reason that I was very interested to see Mr. Retsinas' comments about SWAT teams and I look forward to hearing what he has to say about SWAT teams. Before I get off that

subject, I want to say one other thing about these Section 8 and insured properties. In Operation Safe Home, we have been desperately trying to do something about violent crime at public and assisted housing. All I hear when I go talk to law enforcement people across this country is that the problem is as severe in assisted housing as it is in public housing, but we can't get near assisted housing. Because for security, for drug elimination programs, for tenant assistance, for all those services that poor people in bad neighborhoods need, we have virtually nothing on the assisted-housing side.

I want to give you an example of this. Aurora, CO is a suburb of Denver. Most of the violent crime in Denver is centered around assisted housing in Aurora. The Aurora police department knows that is where its violent crime is, and it came up with a project that involved the local police and us; didn't cost a lot. They put in \$60,000 of their money. They wanted a matching \$60,000 from HUD to do a 6-month cleanup in assisted-housing projects, and we couldn't come up with \$60,000.

They put their money in and they spent it, and that was the end of the project because we couldn't come up with \$60,000. I just think we should be thinking about assisted housing in terms of all those other services that we are providing to public housing.

Moving on to the second issue: it is—you asked about the rents in these project-based Section 8 projects. Recently, just in December, HUD analyzed a sample of its HUD-insured Section 8 new construction and substantial rehabilitation stock of 4,000 assisted properties. This analysis concluded that three-quarters of this housing stock had assisted rents in excess of the rents of unassisted units in the neighboring areas.

Approximately 42 percent of the properties had assisted rents at or exceeding 140 percent of local unassisted market rents. Our analysis of this situation is that when the rents were initially set, they were deliberately set high with some expectation that, over the long term, rent adjustments would bring assisted and unassisted rents into balance.

In fact, that has not happened. For the projects whose rent increases result from the annual adjustment factors, the rents have simply increased every year. The rents are not supposed to be materially different from unassisted rents, and HUD has had a vehicle for making sure about that. The vehicle is called comparability studies.

If HUD thought the rents were getting too high, it was supposed to do a comparability study and bring them back into balance. What has happened is HUD has never done these comparability studies consistently or necessarily well. Then, in 1988, owners started litigation about whether HUD had the right to do these comparability studies. That resulted in a 1993 Supreme Court decision that HUD had the ability, had the authority.

This authority was restated in the HUD Reform Act of 1989, but the HUD Reform Act said that HUD had to issue implementing regulations. HUD has still not issued implementing regulations, which means that HUD has not done any comparability studies since 1987.

Now, there are on the table a number of legislative proposals that bring more sanity to this area of rents. They would allow us to cap rents and to reduce rents under certain circumstances. I think that we can discuss those measures later. By the way, the OIG supports all of them.

[The prepared statement of Ms. Gaffney follows:]

STATEMENT OF
 SUSAN GAFFNEY, INSPECTOR GENERAL
 ACCOMPANIED BY
 CHRIS GREER, ASSISTANT INSPECTOR GENERAL FOR AUDIT
 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BEFORE THE
 SUBCOMMITTEE ON EMPLOYMENT, HOUSING AND AVIATION
 OF THE
 HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

JULY 26, 1994

Chairman Peterson, and members of the Subcommittee, we are pleased to be here today to discuss problems in HUD's Section 8 project-based assisted housing programs. This hearing is particularly important and timely as HUD's current Administration attempts to tackle problems associated with troubled projects and excessive rental subsidies.

While data show that about 70 percent of HUD's Section 8-assisted multifamily housing stock is relatively trouble-free and appears to be of good quality, a disturbing number of projects are experiencing deterioration and neglect by their owners. Tenants, with their rent subsidies tied to these projects, are essentially trapped in deplorable living conditions. Moreover, the risk exposure for significant financial losses at these troubled projects is enormous. That immediate risk is evident in two ways. First, rent levels at many HUD assisted projects are significantly higher than rents at comparable unassisted units in the area. Second, HUD's insurance funds absorb tremendous losses when deteriorated projects default on their mortgages and insurance claims are paid.

Needed Actions

These troubled projects need immediate attention. HUD must ensure that owners, management agents, mortgagees, contract administrators, and others are providing low-income families with adequate housing under HUD rental subsidy programs, consistent with established housing standards and laws. HUD needs to improve its loss mitigation procedures, including early warning techniques and contract enforcement procedures.

Unfortunately, HUD suffers from some major systemic weaknesses that significantly impact its ability to turn around these troubled projects and improve its management and oversight of the Section 8-assisted multifamily housing stock. Staffing shortages, inadequate data systems and faulty management controls adversely impact everything HUD does. These weaknesses are particularly evident in HUD's multifamily assisted programs. Assistant Secretary Retsinas and his staff have readily acknowledged these weaknesses and have embarked on long- and

short-term plans to do what they can to overcome the past weaknesses. Mr. Chairman, as our testimony today will point out, these improvements are long overdue and HUD will need assistance from OMB and the Congress in order to make meaningful progress.

NATURE AND SCOPE OF PROGRAMS

To put some perspective on the nature and extent of these issues, we would like to provide some brief background information.

The Section 8 program was established in 1974 to help low-income families obtain decent, safe and sanitary housing. The program has two components: tenant-based rental assistance and project-based rental assistance. Section 8 certificates and vouchers are referred to as "tenant-based" assistance; whereas the other types of assistance such as New Construction and Substantial/Moderate Rehabilitation are known as "project-based" assistance. Tenant-based assistance is tied to specific eligible families while project-based assistance is tied to specific properties. Thus, families who move from project-based assisted properties lose their subsidy assistance.

Section 8 project-based assisted properties approved prior to 1979 have their rents automatically adjusted through HUD's Annual Adjustment Factors, which are based on inflationary increases in residential rent and utility and fuel in certain metropolitan areas and the four Census Regions. Projects approved after that date have their rents adjusted by HUD's budget-based method. Under this method, assisted property owners submit annual operating budgets to HUD along with documentation in support of increases in their operating expenditures. Upon request by an owner, HUD uses these submissions to determine if a rent increase is warranted and to what extent.

Over 20,000 properties are currently receiving Section 8 project-based assistance from HUD. These properties serve approximately 1.5 million low-income families. The Federal Government's investment in Section 8 project-based assisted multifamily housing is enormous. Data show that HUD has provided approximately \$131 billion of Section 8 budget authority to support its Section 8 project-based subsidy programs over the past 20 years. Estimated cash outlays of \$4.3 billion were made in each of fiscal years 1993 and 1994. In addition to these direct rental subsidies, the tax code has been used to help finance a large share of low income housing assisted projects. Tax shelters in the past and tax credits currently have provided tens of billions of dollars to the owners or syndicators of the projects.

Many Section 8-assisted projects are HUD insured. In fact, about 75 percent of HUD's insured multifamily housing portfolio receives some form of subsidy from HUD. When HUD insured

mortgages default, HUD steps in and pays the lender essentially the unpaid balance of the mortgage and then starts the long and costly process of managing and disposing of that project. HUD's multifamily insurance programs are inherently risky as demonstrated by the following statistical profile:

- Last fiscal year, HUD-FHA paid over \$965 million of insurance claims.
- At September 30, 1993, HUD-FHA had about \$43.9 billion of insurance in force and had established loss reserves of about \$10.5 billion to cover potential future losses on that insurance.
- At September 30, 1993, HUD-FHA held loans, on which claims were previously paid, amounting to about \$7.8 billion, and \$6 billion of that amount, or 80 percent was nonperforming.
- At September 30, 1993, HUD-FHA held foreclosed properties for sale of about \$823 million and realized losses on the sale of foreclosed properties during the year of about \$357 million.

Mr. Chairman, you can gauge from these numbers that FHA indeed has a great deal of risk exposure and has absorbed and will continue to absorb losses in the billions of dollars.

During the next 5 years, many of HUD's project-based subsidy contracts will expire. These contracts encompass hundreds of thousands of Section 8-subsidized dwelling units currently occupied by low-income families. Late last year, HUD and the National Housing Conference convened a Section 8 Preservation Task Force to explore ways to deal with expiring Section 8 project-based subsidy contracts. The Preservation Task Force completed its proceedings earlier this year, and legislative proposals dealing with the Section 8 preservation issue have been initiated as a result of this Task Force and other efforts. These expiring Section 8 contracts present HUD with a rare opportunity to improve its administration of future subsidy contracts, or to restructure the project-based subsidy programs.

HUD's MANAGEMENT AND OVERSIGHT OF INSURED/ASSISTED PROJECTS

Over the years, OIG audits and reviews by others have questioned HUD's capacity to manage and monitor its huge portfolio of insured and assisted multifamily properties. In fact, since 1987, HUD has been reporting the area of multifamily loan servicing as a "material weakness" pursuant to the Federal Managers' Financial Integrity Act. Recently, our semiannual reports to the Congress and our financial statement audits of FHA have consistently pointed out three systemic weaknesses that

impact HUD's ability to manage and monitor multifamily programs. More specifically, our Office has been reporting the need for concerted efforts to address resource shortages, inadequate data systems, and an ineffective management control environment, including a lax enforcement program.

STAFFING RESOURCES

HUD currently lacks needed resources in terms of numbers and expertise to adequately service the loans and Section 8 contracts in an efficient and effective manner. A clear and compelling demonstration of the scope of HUD's staffing shortages in this regard was contained in the most recent Price Waterhouse audit report on FHA. That report pointed out the wide disparity between staffing levels at HUD and at other entities involved in multifamily housing lending. Whereas state housing finance agencies have staff/loan ratios of 1 to 20, each HUD staff person has an average workload of 50 loans. Price Waterhouse went on to point out that HUD loans are typically much riskier, more troubled and thus more staff intensive, making the noted disparity even greater. We believe that the staffing problems at FHA are at the critical stage.

DATA SYSTEMS

The impact of staffing shortages could be offset somewhat through economies relating to the use of automated data. However, HUD does not have effective and integrated automated data systems that can be relied upon to provide relevant, timely, accurate, and complete information. This has contributed to fraud, waste and mismanagement in many of HUD's programs, including the Section 8-assisted multifamily housing programs. Although it is impractical to determine the potential dollar loss resulting from HUD's inadequate data systems, the losses in terms of misspent subsidies, insurance claims and asset management inefficiencies likely runs in the hundreds of millions of dollars.

MANAGEMENT CONTROLS

Our audits have disclosed that HUD's management controls in the insured/assisted multifamily housing area are weak. For example, Field Office physical property inspections, financial statement reviews, and on-site management reviews have not been performed in a manner that consistently identifies and resolves problems. This often contributes to insurance claims, unacceptable housing conditions, and excessive or wasteful subsidies.

In addition, HUD Field Offices are not adequately following up with property owners and their management agents to ensure that problems identified through HUD's monitoring are being addressed in an acceptable manner. Moreover, HUD has not always taken

appropriate action to stem and recover excessive or unnecessary Section 8 subsidies.

CONDITION OF ASSISTED MULTIFAMILY HOUSING STOCK

While available data indicate that about 70 percent of HUD assisted housing stock is of good quality, a disturbing number of projects are distressed and low income tenants are trapped in deplorable living conditions. HUD sponsored studies and routine monitoring procedures often point out the poor quality of some units. In addition, our internal and external audit reports over the years have cited substandard units that continue to obtain subsidies because HUD does not enforce its contracts to obtain corrective actions, or recover misspent funds.

HUD STUDY

The HUD Reform Act of 1989 required that HUD conduct a study to determine the physical renovation needs of the Nation's federally assisted distressed multifamily housing inventory and to estimate the cost of correcting deficiencies and then maintaining the projects in adequate physical condition.

The study gathered data on over 13,000 insured properties, 10,000 of which were also assisted by Section 8 or other HUD subsidy programs. The study determined that about 23 percent of the assisted properties were distressed, i.e., conditions jeopardized tenants' well being, impaired sound operations, and, if not corrected, will lead to financial failure. Another 15 percent were determined to be stressed, i.e., conditions were such that continued neglect over a short period would move the property to the distressed category. The study also estimated that the 10,000 projects had physical improvement needs estimated to cost \$1.1 billion and that the projects had only about \$145 million in project reserves to fund the needed repairs. This equates to a shortfall of \$955 million.

OIG INTERNAL AUDITS

Two specific OIG audits are noteworthy in discussing housing quality. In 1990, we performed a review of the HUD Cincinnati Office to determine how well that staff was administering Section 8 contracts. As part of that review, we inspected a representative sample of 86 assisted units at 15 property disposition projects. Our inspectors failed 82, or 95 percent, of the units we inspected. Those units had a total of 507 housing violations and most of the units would be considered substandard.

In April 1993, we issued a multi-region audit report covering HUD's servicing of insured/assisted multifamily housing projects. The audit work was performed during 1991-1993. As part of our

review, we inspected 28 troubled multifamily housing projects under the jurisdiction of six HUD Field Offices and determined that the physical condition of 23, or 82 percent, was unsatisfactory or below average. Of the 28 projects inspected, we determined that 20, or 71 percent, had inadequate preventive maintenance programs. Our tests also showed that HUD staff had not performed any recent Housing Quality Standards (HQS) inspections for 17 (61 percent) of the 28 projects we inspected.

The audit also disclosed that HUD-insured multifamily projects remained in poor physical condition for extended periods of time and that units receiving Section 8 LMSA assistance often failed to meet HUD's housing standards. With respect to the latter, we inspected 314 Section 8 LMSA-assisted units and determined that 216, or nearly 69 percent, failed to meet HUD's housing standards. The factors contributing to these conditions were as follows:

- HUD inspection reports did not consistently identify all major repairs and their seriousness, the cost of repairs, and the location of deficiencies.
- Field Office follow-up actions and corrective action plans were often inadequate to correct violations.
- Mortgagee inspection reports were not used by Field Offices because they considered them to be unreliable or useless.
- Field Office inspections did not always entail checking for compliance with HUD's Section 8 Housing Quality Standards.

OIG EXTERNAL REVIEWS

Rosedale Ridge

The Rosedale Ridge project, located in Kansas City, is a 161 unit complex which was insured under HUD's Section 236 program. Eighty one units received Section 8 assistance. Mortgage interest rate reductions and rent subsidies approximated \$343,000 per year. The owners purchased the project in 1986.

In August 1989, at the request of HUD managers, OIG audited the project and disclosed numerous equity skimming violations amounting to \$799,068.

During the audit, we found that most apartment units contained serious tenant health and safety hazards, including roach infestation, falling ceilings and windows, and doors that did not provide security or protection from the weather. The estimated rehabilitation at the project was \$1.4 million. Many of the

families at this project did not have the luxury of being able to move to another apartment of their choice because they relied on the HUD unit based subsidies to help make their rent payments.

The mortgage went into default and was assigned to HUD in October 1990. HUD paid a mortgage insurance claim of \$1.8 million and the project was foreclosed in February 1992. The project was subsequently sold at a loss of \$1.4 million. To maintain the low income character of the project, HUD agreed to provide Section 8 subsidies for all the units in the project with a contract that will cost HUD \$10.7 million over a 15 year term. Additional costs to the Government include Low Income Housing Tax Credits worth about \$710,000. Thus the total cost to the Federal government in this case of equity skimming is staggering indeed.

Based on the results of this audit we referred the irregularities for investigative action and later performed an audit of six other projects owned by parties related to the owner of Rosedale Ridge. These audits showed similar patterns of abuse. The owners were looting the projects and tenants were forced to live in deplorable living conditions. We identified about \$1.1 million in additional equity skimming at those projects. HUD paid insurance claims in excess of \$7.7 million on four of these six projects.

OIG and FBI special agents investigated this case on a comprehensive basis for about two years. These efforts culminated in October, 1993 when four of the project principals pled guilty. One of the owners began a prison term in July 1994, one was sentenced last week and the other two individuals are awaiting sentencing. In addition, based on the guilty pleas, a civil fraud case was brought against the owners and in December 1993, a \$1.6 million double damages judgment was awarded to the government on the Rosedale Ridge project. Additional civil actions are being pursued on the other projects.

SNAP I, II, and III

SNAP I, II, and III is located on scattered sites within a historic district of Savannah, Georgia. The project consisted of three phases made up of 233 Section 8 assisted units. As early as August 1991, HUD's Field Office was reporting serious disrepair at the project. As of February 1993, the OIG inspector estimated the repair costs at approximately \$1.2 million.

In February 1992, HUD threatened to abate Section 8 rents if the next HQS inspection (scheduled for March 1992) noted violations that were not corrected within 30 days.

The HUD March 1992 HQS inspection showed that 216 of the project's 233 units (or 93 percent) did not meet HQS. HUD notified the owner of the inspection results in July 1992, 4

months after the inspection. HUD informed the owner that the deficiencies must be corrected by August 1992 or they would abate Section 8 subsidies effective September 1, 1992.

In August 1992, HUD officials met with the owner and agreed to postpone the abatement. The owner was having a problem obtaining funds to correct the problems, so the owner was given 1 year to correct the HQS violations.

In February 1993, we inspected 17 occupied Section 8 units, and found that they all failed the HQS inspection. The OIG inspector found many of the same uncorrected deficiencies noted in HUD's March 1992 HQS inspection. These deficiencies included serious matters such as exposed wiring, roach and rodent infestation, and structurally unsound windows, doors and walls. From the date of the HUD's inspection through February 1993, HUD paid \$64,861 in Section 8 subsidies for the 17 units that did not meet program standards.

We referred this case to HUD's Office of General Counsel for possible false statements under the Program Fraud Civil Remedies Act. This Act authorizes agencies to recover up to double damages and civil penalties on the basis of claims that include false material facts. The owners were certifying on their monthly requests for Section 8 payments that the units were in decent, safe, and sanitary condition. This case was declined on the basis that 1) HUD's leniency in continuing to make Section 8 payments directly contradicts any claim by HUD at this time, and 2) HUD's knowledge of the condition of the units mitigates the false statements made by the owner.

Bethal Church Homes

Bethal Church Homes, located in Athens, Georgia, consists of two phases and 190 units of which 183 (96 percent) are Section 8 assisted. At the time of our audit, the project needed repairs totaling \$2.1 million. The need for the repairs developed over time due to the owner's inadequate maintenance of the project. HUD reported that 80% of the repairs were for HQS violations.

OIG inspected 14 occupied Section 8 units; all 14 failed with HQS violations such as exposed wiring, roach and rodent infestation missing or broken smoke detectors, and structurally unsound windows, doors, and walls. HUD was paying \$3,900 per month in Section 8 subsidies for these 14 units.

In December 1993, we referred this case to HUD's Office of General Counsel for a possible false statement by the owner or management agent under the Program Fraud Civil Remedies Act. The owner certifies on the monthly Section 8 payment voucher that the units, for which payments are being requested, are in decent, safe and sanitary condition. The case is still under review.

PROGRAM ENFORCEMENT

Program enforcement can be an integral control in rooting out fraud and abuse in HUD programs. However, HUD's program enforcement has been particularly weak for many reasons. As discussed earlier, staffing shortages and inadequate data systems preclude effective efforts to monitor owner performance and detect situations demanding remedial actions. Even when problems are detected, enforcement obstacles exist. Typically, HUD has not taken aggressive enforcement actions because effective enforcement actions could harm the tenants or HUD. Consequently, owners are allowed to have the upper hand in the enforcement arena. For example:

- If HUD declares a default of an insured mortgage, this results in acceleration of the debt by the mortgagee, the payment of a claim from the FHA insurance fund, and a lengthy and expensive disposition process.
- If HUD defaults a Section 8 contract or other subsidy contract, this results in a recapture and rescission of the contract authority. However, the subsidized tenants are then left without affordable housing.
- If HUD abates the Section 8 payments on a significant number of units in an insured project, the cash flows decrease, the owner cannot pay the mortgage or repair the units, the residents continue to live in unacceptable housing and HUD pays a claim from the insurance fund.
- If HUD decides, as a last resort, to foreclose on a project because the owner refuses to take needed corrective actions, the owner may quickly hide behind Bankruptcy Act protections to delay HUD action, thus causing more costs and deteriorated units.

Other tools employed by HUD may also exacerbate the problems that exist or fail to provide a cure. Such tools as decreasing the number of Section 8 units or denying rent increases ultimately tend to hurt low income tenants and not the project owner, whose personal financial status remains unchanged.

All of these concerns, coupled with the staff intensive and lengthy processes involved in taking action, have contributed to a culture at HUD that results basically in a wholesale disregard for available enforcement tools. Housing quality violations go virtually unchecked. A small fraction of misspent funds are recovered in the multifamily housing area, thereby providing little incentive for owners and agents to adhere to HUD's requirements.

The Office of Multifamily Housing, under the leadership of Nic Retsinas and Helen Dunlap, has embarked on an effort to change the program enforcement culture at HUD. A task force, consisting of Headquarters and Field Office staff, has been analyzing current tools and developing possible ways to improve performance in this regard. Without adequate staff and timely data, HUD is severely limited in what it can do to detect problems and then take the appropriate corrective actions. The enforcement task force is attempting to develop some short term measures that can work despite the staff and system weaknesses. We certainly applaud these efforts and are supporting the task force in several significant ways.

Needed Actions

HUD is currently taking action on a number of fronts to improve its management and enforcement of assisted multifamily housing. In the program enforcement area, legislation has been proposed to improve the multifamily housing equity skimming statutes, to expand civil money penalty provisions, and to allow HUD to recapture Section 8 subsidies that now would be lost through rescission if enforcement actions are imposed on owners. We fully support these legislative initiatives and urge Congress to act favorably upon them. HUD is also proposing to modify the Bankruptcy Code and to obtain more authority and flexibility to foreclose on defaulted properties in a more timely and less costly manner.

In addition, we believe that HUD needs to consider other long-term changes to the structure of its multifamily housing programs that could significantly change owners' current incentives to engage in equity skimming. Such changes would include issues dealing with cash equity investments, recourse debt provisions, and tax law changes.

On the management side, we support current efforts to increase the amount of funding for Section 8 property disposition. In this regard, the proposed Housing Choice and Community Investment Act of 1994 would shift Section 8 property disposition from a discretionary funding source to a mandatory account, i.e., the FHA General Insurance Fund or Special Risk accounts, whichever is applicable, rather than through funds provided under the U.S. Housing Act of 1937.

We also recommend that HUD move forward expeditiously to improve its system for compensating multifamily management companies to provide for greater incentives for better performance by such companies. Another possibility worthy of consideration is for HUD or some privately based organization to establish a certification program for managers of HUD-assisted multifamily housing projects, which might encompass Section 8 contract administrators as well.

Another area which we consider vitally important concerns the transfer of ownership of some assisted multifamily properties. We believe that HUD, in concert with Congress and OMB, needs to develop innovative and cost-efficient ways to transfer ownership of some assisted multifamily properties to nonprofits and others. This entails the need to address the issues of owners' exit taxes, bond issuance and refunding, use of project reserves, and purchase costs of properties, among other areas.

Mr. Chairman, while we applaud the efforts of Mr. Retsinas and his staff in recognizing the problems and moving ahead with proposed solutions, we want to also emphasize that most of the matters discussed above are long-term in nature. Significant actions need to be taken now. HUD must move aggressively against bad owners on a high priority basis, and must find ways to augment its inadequate staff with contractors or other parties. HUD cannot afford to wait for legislative and regulatory changes if it hopes to overturn the deplorable living conditions confronting many assisted tenants.

HIGH OR EXCESSIVE SECTION 8 SUBSIDIES

There is a great deal of evidence that project based Section 8 assistance is significantly higher than comparable unassisted units in many communities. HUD studies, GAO reports and OIG audit reports have pointed out serious problems in this area.

HUD STUDY

HUD recently analyzed a sample of its HUD-insured Section 8 New Construction and Substantial Rehabilitation stock of 4,125 assisted properties. Based on this analysis, it concluded that about three-quarters of this housing stock had assisted rents in excess of the unassisted rents they would likely command in their local markets (even after completing a program of repairs and upgrades of amenities). According to HUD's analysis, approximately 42 percent of the Section 8 properties had assisted rents at or exceeding 140 percent of local unassisted market rents. HUD found that only 23 percent of the Section 8 properties had assisted rents at or below optimal market rents.

HUD's analysis also showed that, because of project debt service requirements, most of the Section 8 projects reviewed would experience financial shortfalls if their rents were lowered to the local unassisted rent levels. Further, this would be true even if the loans could be refinanced at much lower interest rates. In addition, the current value of many projects would not be high enough to allow refinancing even under very favorable loan-to-value standards and refinancing costs.

OIG AUDITS

Over the past 5 years, our Office has issued three major internal audits that discuss the high cost of Section 8 project based assistance.

In April 1994, we issued a report summarizing our review of the Multifamily Preservation Program. We concluded that the program as designed by Congress is not flexible enough for HUD officials to seek lower cost options to preserving housing. Congress recognized the preservation program would be expensive when they passed the Preservation Acts (1987 and 1990). However, they found no other alternatives acceptable at that time. We provided potential options that could save from 29 to 81 percent of the projected Section 8 costs. With an estimated 401,000 units eligible for funding under the program, the options could equate to savings in the tens of billions of dollars.

In April 1993, we issued a report covering HUD's administration of bond refundings for Section 8 projects. The major focus of that audit was HUD's need to revise its current policy and practice relating to applying Annual Adjustment Factors to numerous bond financed projects. We estimated that at least \$200 million in excess rent increases had been granted by HUD and, without needed changes, future increases could be in the billion dollar range over the terms of the Section 8 contracts.

In April 1989, we issued a report on the Section 8 Moderate Rehabilitation Program. The major findings in this review related to questionable practices in awarding the funding and the inappropriate approval of excessive rents. This report was the driving force in numerous Congressional hearings and the subsequent conviction of several former HUD officials. The report estimated that excessive Section 8 rents would amount to over half a billion dollars over the terms of the Section 8 Contracts. In addition, the report pointed out the waste of billions of dollars in Low Income Housing Tax Credits on these projects.

The common themes in these reports are the significant problems associated with the structure of the project based subsidy programs that contribute to situations where HUD subsidized rents are initially set much higher than unassisted rents in many communities. These problems are compounded by HUD's inability to control or limit rent increases.

When an owner's Section 8 contract rents are being adjusted or increased through HUD's Annual Adjustment Factors, HUD must ensure by law that any resulting adjusted contract rents will not be "materially" different than the rents of comparable unassisted units in the local market area. When HUD has reason to believe that a "material" difference exists, its policy has been to

perform a comparability study. This study consists of surveying local rents in a small geographic area surrounding the HUD-assisted project whose adjusted rents are being questioned. HUD can use its comparability study to cap the amount of any proposed rent adjustment.

Despite the importance of HUD's comparability studies, the Department has not ensured that these studies are performed when appropriate. Over the years, there has been much confusion and inconsistency among HUD's Field Offices in applying comparability studies to proposed Section 8 rent adjustments. Our reviews have disclosed that Field Offices have either failed to perform such studies when warranted or failed to perform them consistently. Also, commencing in 1988, HUD's comparability studies have been the subject of extensive litigation by owners of HUD-assisted properties. The culmination of this litigation was a decision by the U.S. Supreme Court on May 9, 1993, which ruled that HUD had the authority under its Section 8 subsidy contract to perform rent comparability studies.

Although the HUD Reform Act of 1989 also reaffirmed HUD's authority to perform Section 8 rent comparability studies, the Act directed HUD to issue regulations in support of such studies. As of the current date, HUD has not yet issued its final rulemaking on comparability studies; therefore, comparability studies have not been performed since December 1989, when a HUD-imposed moratorium was placed on the performance of such studies, pending issuance of the Department's regulations.

In addition, our reviews have disclosed that HUD has experienced problems with its budget-based method of adjusting owners' rents. We have found that owners do not always perform budget-based reviews adequately in that some rent increase requests have been granted without the benefit of adequate supporting documentation and supervisory review of processing decisions. We have found that excessive budget-based rent increases have been granted by HUD on occasion. The budget-based method of adjusting Section 8 rents is very staff-intensive when this method is applied properly. In addition, HUD cannot ensure that Section 8 project operating costs compare favorably to the operating costs of comparable unassisted projects in local markets, primarily because its data systems are inadequate and lacking such information. This is particularly a concern due to the fact that some owners use identity-of-interest management companies to operate or service projects.

NEEDED ACTIONS

There are many actions available to Congress and HUD to address the problems of potentially excessive Section 8 project-based subsidies. All potential actions need to be considered, regardless of how controversial or sensitive they might be.

The Administration's proposed Housing Choice and Community Investment Act of 1994 (S. 2049) contains four initiatives which will reduce unnecessary Section 8 project-based subsidies by capping rent increases based on the Annual Adjustment Factors (AAF), providing incentives for owners to refinance high interest mortgages, eliminating the requirement to automatically renew LMSA contracts, and reducing the AAF when renters stay in their units. The OIG supports these proposals, and I strongly recommend that they be enacted by the Congress.

We also recommend that HUD expedite the issuance of its final rulemaking in support of Section 8 rent comparability studies. We believe it is imperative that HUD perform comparability studies since this is one of the few controls that the Department has to prevent excessive or unwarranted rent increases in the Section 8 program.

Another alternative is to freeze Section 8 Annual Adjustment Factors for certain locations until such time as all material differences between Section 8 rents and comparable unassisted local market rents are eliminated. We also believe that Congress should consider repealing Section 8(c)(2)(C) of the United States Housing Act of 1937 which, in most circumstances, prohibits HUD from applying Annual Adjustment Factors to reduce any contract rents in effect on or after April 15, 1987 for projects in the Section 8 New Construction, Substantial Rehabilitation and Moderate Rehabilitation programs.

Another available option which needs to be pursued more frequently by HUD is the Department's consideration and application of projects' excess reserves to accommodate increases in owners' operating costs in lieu of granting rent increases which entail additional subsidy dollars. We also believe that HUD should revise the Section 8 Housing Assistance Payments Contract for contracts undergoing renewal to provide the Department more flexibility to set and adjust Section 8 rents so as to better ensure comparability with local unassisted market rents.

Lastly, Congress should continue to provide HUD sufficient funds to perform Random Digit Dialing surveys of small local market areas or segments of larger areas as a means of establishing Section 8 Fair Market Rents and Annual Adjustment Factors. These surveys have proven to be an effective means of improving the accuracy of Section 8 rents in many areas of the country.

Mr. Chairman, that concludes my statement for the record. My colleague, Chris Greer, and I would be happy to answer any questions you or other Subcommittee members may have.

Mr. PETERSON. Thank you. Ms. England-Joseph stated that she was talking about the increasing civil penalties. As I understand it, HUD has never proposed a civil money penalty on anybody ever, is that true?

Ms. GAFFNEY. No, I think that is not correct. I asked that question the other day and the answer I was given was that—and perhaps Mr. Retsinas has better information—HUD has in fact assessed civil money penalties against lenders for certain fair housing, but not against owners. One of the reasons they don't do it is because these are single entity organizations, so you are going against the proceeds of the projects, you are not getting at the owners.

Mr. PETERSON. Well, I think it calls into question whether these projects, this program makes sense, frankly.

Mr. Flake, we welcome you to the committee. We are proceeding here. Apparently, we have to adjourn at 11 a.m. unless you can tell us there is some rule that we don't have to, perhaps you know something I don't know. Welcome to the committee.

Mr. FLAKE. I know there are Whitewater hearings in another room, and I am supposed to be there also. I think I would rather be here with you and Mr. Retsinas and others, so I am going to stay.

Mr. PETERSON. Well, with that we will move to Assistant Secretary Retsinas. We appreciate you being with us today. We may have to interrupt you in the middle—

Mr. RETSINAS. Would you like me to begin after the recess, Mr. Chairman?

Mr. PETERSON. Why don't we get started, and we will get through this as far as we can. I don't know if they are going to come in here and haul us away or what they are going to do, but we will see.

STATEMENT OF NICOLAS P. RETSINAS, ASSISTANT SECRETARY, HOUSING, AND FEDERAL HOUSING COMMISSIONER, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, ACCOMPANIED BY HELEN DUNLAP, DEPUTY ASSISTANT SECRETARY, MULTIFAMILY HOUSING, AND JUDGE NELSON DIAZ, GENERAL COUNSEL

Mr. RETSINAS. Thank you, Mr. Chairman. I will stay as long as you do. Mr. Chairman, members of the committee, it is indeed a pleasure to be here. You have already acknowledged my Deputy for Multifamily Housing, Helen Dunlap. I also want to acknowledge our general counsel, Judge Nelson Diaz, who is also here this morning.

Thank you for inviting us here today. I especially want to thank you for sharing our sense of urgency about the physical and financial condition of our Nation's assisted housing. Well, the truth is that the majority of this assisted housing is both financially and physically sound, but frankly, Mr. Chairman, there is no comfort in that for the people who live in the assisted housing that is at risk.

Our position is as long as anyone who is forced to live in substandard conditions in federally subsidized housing, as long as taxpayers feel they are paying inordinately to subsidize such units, we

must not allow these statistics to dull our sense of urgency about this issue. A few moments ago we saw videos of both well-managed and troubled assisted housing. These images are much more vivid and touch people more deeply, much more than any testimony I could give here today. We saw structures that can be considered housing only in the sense that they still have exterior walls and roofs. We saw broken windows, doors that didn't lock, ceilings that were falling in, plumbing that didn't work, broken fixtures, exteriors littered with trash.

Mr. Chairman, we don't need to look at a video for that. We can actually see housing like this any day of the week within a 15 or 20-minute walk of this hearing room. There are families living in taxpayer subsidized, FHA-assisted housing in conditions that none of us would tolerate for even a minute.

Beyond the question of living conditions, Mr. Chairman, there is a larger issue of community viability. The worst of our assisted housing stock is in our most distressed neighborhoods, at the heart of our most distressed communities. This substandard housing is a contributing factor to the physical, economic, and indeed spiritual deterioration of these neighborhoods and communities.

President Clinton and Secretary Cisneros have made revitalization of these neighborhoods and communities a top priority for HUD and for this administration. As you know, in the empowerment zones initiative, Congress has already committed substantial tax dollars toward this goal, but that commitment just begins to address the need. At the same time, Mr. Chairman, deteriorating taxpayer subsidized, FHA-assisted housing is feeding the very decay we are trying to reverse.

Mr. Chairman, this is an outrageous affront to the taxpayers and to common sense. We cannot revitalize communities without turning this distressed assisted housing around. Just as you noted, we must turn around severely distressed public housing. For the sake of individuals and families and for the sake of the long-term health of these communities, action on this problem is imperative.

We understood at the very beginning of our watch that we had inherited a critical problem in assisted housing. Last year, shortly after Secretary Cisneros took office, he testified before Congress that the condition of FHA's multifamily portfolio was the most serious problem facing HUD. We found then that an estimated \$11.9 billion of our \$45 billion portfolio was at risk.

Our experience in the 18 months since then, Mr. Chairman, has shown us that the situation for residents and communities is even more critical than we had first thought. That is not because the situation has gotten worse. It is because we have taken a clear, honest look at it. Realizing, as has been previously noted, that our own manpower staff resources were literally overworked and overwhelmed, we contracted with outside inspectors to identify physical problems with properties.

We also initiated a closer analysis of properties' financial conditions. A property's financial situation is a good indicator of its likely physical condition, and this analysis has red flagged additional properties that are likely at physical risk as well as financial risk. Our eyes are open. We now see the full dimensions of the problems

we face, and they are formidable. How did we get into this mess and how do we get out of it?

To a great extent, as one of your colleagues noted, the problems of assisted housing developments today stem from the fact that they weren't built primarily to provide decent affordable shelter for low-income families. In many cases they were built to provide tax shelters for investors. As long as the tax benefits lasted, it was still possible to raise the capital required to maintain these developments, but the Tax Reform Act of 1986 eliminated these benefits, and the partnerships that had been formed to finance the construction of these tax-shelter-driven projects no longer had any incentive to invest in them.

Ownership became a liability, not a benefit, and many partners simply walked away. This is a sorry financial fact of life, and complaining about it doesn't solve anything, but this unfortunate history is absolutely no excuse for allowing these developments in which the taxpayers have already invested so much in foregoing tax revenues and spending rent subsidies to fall into disrepair and worse. It is no excuse for us to look the other way while the owners of these properties abuse them and the people who live there.

There are other factors which have contributed to the deterioration of assisted housing, and they are all amenable to correction. There are owners and managers who have not performed well. In some cases, there has been outright diversion or skimming of funds that should have been used to maintain and improve properties. In other cases well intentioned owners and managers have been literally overwhelmed by the immensity of the problems they face. In others, even competent and qualified owners and managers simply have not had the resources they needed. Yes, there are also residents who have been both disruptive and destructive.

HUD's own policies and management deficiencies have exacerbated the problem. As bad as things are with respect to the smaller troubled portion of FHA's multifamily portfolio, I believe the situation is fixable over time. First, this distressed housing can be rehabilitated. We can transform these liabilities into assets, but we must have resources.

Second, we can correct the ownership and management problems which have contributed to their disrepair, but we need legislative and regulatory changes. Third, through additional changes in the law, we can change the dynamics of these developments so residents can become part of the solution instead of the problem. And, fourth, we at HUD can and are changing our own policies and procedures. We can turn this housing around, Mr. Chairman, and we can turn whole communities around with it. That will require a comprehensive strategy, and we have one.

It is a fourfold strategy built around enforcement, repair, resident responsibility, and transforming the way we do business at HUD. We have already begun to implement it, and I would like to take a moment to tell you about our progress to date.

Mr. Chairman, I can't emphasize enough that our ability to carry out this plan, this strategy is directly related to the resources at our disposal. First, enforcement. We are already limiting participation of individuals, companies, or agencies that have been involved

in past wrongdoing, and in the case of serious violations, permanently disbarring them from participating in HUD programs.

In 1993 and the first 6 months of this year we issued 58 debarments involving 34 privately owned and management multifamily developments and 24 housing authority operated developments. As a matter of fact, we actually issued as many debarments in the first 6 months of this year as in all of 1993.

In the case of individuals, companies, or agencies who have already shown themselves to be unreliable, we have zero tolerance for further wrongdoing. However, these are essentially preventive tools which are effective in dealing with individuals, companies, and agencies who have already participated in HUD programs. If someone has no track record with us, these tools are of limited use.

We are taking other actions to expand enforcement. We are stepping up our physical inspections of properties and citing owners for failing to meet housing quality standards. We are deploying six SWAT teams to restore 30 to 40 severely troubled projects each year which we have determined can be restored to physical and financial health.

I might add, the number could expand significantly if the resources were there to support them.

We are acting more aggressively to identify cases where owners have diverted funds. For the first time, we are systematically collecting, automating, and analyzing the annual statement of every multifamily project. All the annual financial statements of insured or HUD-held multifamily projects will be entered into a data base. This will enable us to more quickly identify problem projects and track the flow of money through them. This work is being done by outside contractors who are currently entering the financial statements of the last 3 years into the data base. They have already entered 65 percent of the 1993 data and are beginning to review and analyze it.

Through our coinsurance asset management contract, we have collected over \$40 million in excess cash that was being held improperly by owners of formerly insured properties. Our contractor has also identified many instances in which funds were illegally diverted and unauthorized payments were made. We are pursuing civil and criminal actions against violators as part of Operation Safe Home.

Second, repair. Clearly, physical repair of properties is essential to turning them around. To date our field offices have received and approved 950 plans to repair and rehabilitate properties in our assisted-housing inventory. Last fall we committed to approve 1,200 plans this year, and we expect to exceed that goal by 10 percent.

At this point I would like to give you some examples of what can be done when we do have resources. In Pompano Beach, FL, the Holiday Lake Apartments which you saw in the video were in serious trouble. We have forced a change in management there. We have invested \$856,000 in flexible subsidy funding. The owner has invested another \$280,000.

We have committed additional Section 8 funding to the property and we have released \$194,000 from the replacement reserve, and the property is now being turned around.

In Chicago, at 6000 South Indiana, also in the video, we forced a management change. We committed \$1 million in special rent increases, which will be paid through subsidies, to finance capital improvements over a 3-year period. We committed \$200,000 in drug elimination grant program funds for improved security, closing down what was for all intents and purposes a drug bazaar in the building lobby. We are refurbishing all the units, replacing countertops, kitchen cabinets, plumbing fixtures. We are repairing the roof and replacing every window in the building. All of this work will be completed by the end of this year.

Mr. Chairman, this is what we are doing with the resources we have now. With additional resources and certain legislative changes which I will discuss in a moment, we can do much, much more.

Third, resident responsibility and supports. Mr. Chairman, we can reform management and make physical repairs, but we won't make real progress unless we also change the human dynamics of assisted housing. Residents must be encouraged to take responsibility for their own lives. They must be able to see assisted housing as a place to make a transition to better lives. That means we have to make social services part of this housing work.

Here in southeast Washington in Atlantic Gardens there is now a daycare facility, a child learning center, and a special summer program for young people in cooperation with the police department. These kinds of services enable parents to seek and hold jobs, they strengthen family life, and we must expand them. We must also change the demographics of assisted housing so that we don't concentrate very poor people in these developments. When we pile poor people on top of poor people in developments, where absolutely everyone is very poor, unemployed, or on public assistance, we are really asking for problems.

In an environment like this, residents have no role models. They have no access to the kinds of word-of-mouth networks that really lead to jobs. They cannot even begin to see a way out of poverty no matter how much they would like to find a way out. We must alter the residential makeup of these developments so that poor people live alongside working people.

Fourth, transforming HUD. We are transforming HUD into a results-oriented department that puts progress ahead of process. Departmentwide, we are eliminating an entire middle layer of regional bureaucracy and giving our field staff more responsibility and authority to make decisions. For our assisted housing inventory this means our field managers will have more freedom and discretion to pursue diversions of funds.

We are shifting more resources to the field. We are augmenting our existing staff with long-term temporary employees, and we anticipate hiring some permanent positions in the field offices. We will be hiring more than 80 people in our field offices, specifically to beef up our asset management efforts. Starting this fall, we will begin holding multifamily mortgage note sales to free up staff resources that are now being directed to servicing HUD-held loans rather than making sure that future loans are made in a sound manner.

We have also implemented a housing technician training program to sharpen our staff's asset management skills. These are immediate steps we are taking to improve our operation in the short run. Over the long run, Mr. Chairman, we must transform FHA to be more responsive to the communities we serve. We must be a better partner with the private sector, and with nonprofit community-based organizations.

Tomorrow, as a matter of fact, we are inaugurating a series of forums on the future of FHA. These forums will be conducted in eight cities around the country and will help us reevaluate our role and help us determine how we can better structure FHA to deliver services to the public in addition to rethinking how we deliver service.

Mr. Chairman, we are reviewing our policies to ensure that they promote the hard results that we want to achieve. For example, with respect to physical maintenance of assisted housing, we are considering a major policy revision which will make it easier for partnerships to advance the capital needed for repairs.

Currently, an owner who advances capital may not recover it until a project is in a surplus cash position. However, some of the most troubled projects which require large capital advances may never be in that position. This rule thus serves as a major disincentive to investment, discouraging owners from doing exactly what we want them to do, infuse new capital into projects when it is needed.

We will change our policy so that owners can invest new capital and recover it over time. This is what we have already undertaken, but quite frankly, Mr. Chairman, we need your help, and the help of your committee to finish this job. We need legislative changes, and we need resources, Mr. Chairman.

There are a number of things I would urge you and this committee to consider. One, our Flexible Subsidy Program, which enables us to step in to developments like Holiday Lake Apartments and help finance needed repairs, must be increased. Two, we must have a Capital Grant Repair Program, which can be targeted at any assisted property with or without mortgage insurance.

Three, we would like to see a change in the treatment of recovered Section 8 subsidies. Today, when HUD recaptures Section 8 subsidies as a result of successful enforcement actions that recaptured budget authority currently returns to the Treasury and is lost to us. Subject to appropriations, that budget authority could be used to fund another project-based contract or be converted to a resident-based subsidy such as vouchers. This would enable us to take enforcement actions without reducing the supply of decent, safe, and affordable housing.

Currently, owners cannot transfer their property to new ownership, with new capital and renewed commitments to maintain the housing affordability, without incurring substantial tax liabilities. This means the owners' tax consequences drive decisions instead of the best interests of the taxpayers and the residents. We must find a way to give owners an incentive to turn these properties over so others can turn them around.

In addition, HUD must not be bound by bankruptcy stays when owners attempt to avoid foreclosure by hiding behind the protection of bankruptcy courts.

Next, civil money penalties which are currently pending in the companion Senate bill should be expanded to include identity of interest management agents and owners who enter into Section 8 contracts without mortgage insurance. The Federal preference requirement for project-based Section 8, which determines the percentage of units that must be reserved for the most needy families, should be lowered to bring it in conformance with housing authority-sponsored Section 8 to permit more income mixing in these developments. We must have discretion to increase rents in some cases, and thus subsidies, for projects which face unusually difficult and legitimate problems.

Mr. Chairman, there are properties where legitimate needs have simply outstripped rental income, and in those cases we must have the flexibility to adjust rents on the basis of actual budgets instead of simply on the basis of an automatic annual adjustment factor for inflation. Otherwise, these developments will face continuous cash-flow deficiencies, leading to poor maintenance and ultimately to substandard housing.

Finally, Mr. Chairman, the shallow rent subsidy concept in the Senate bill should be expanded to all applicable Section 8 programs. This will enable us to attract working people who need less subsidy to assisted housing which will help promote mixed income Section 8 communities.

Mr. Chairman, I know there are people in this room who question HUD's ability to address the problem which is, in part, of its own making, but Mr. Chairman there is a new team at HUD today and a new spirit. Secretary Cisneros and I are firmly committed to restoring our distressed assisted housing. We can do it and we will do it, but first we must have the tools and resources to get the job done.

Mr. Chairman, members of this committee, I urge you to give us those tools and resources. Together let us assure that the past does not become self-perpetuating, but rather a prologue to a much better future. Thank you.

[The prepared statement of Mr. Retsinas follows:]

Statement before the
Committee on Government Operations
Subcommittee on Employment, Housing and Aviation
United States House of Representatives

July 26, 1994



NICOLAS P. RETSINAS

ASSISTANT SECRETARY FOR HOUSING
FEDERAL HOUSING COMMISSIONER

STATEMENT OF

NICOLAS P. RETSINAS
ASSISTANT SECRETARY FOR HOUSING - FEDERAL HOUSING COMMISSIONER

before the

COMMITTEE ON GOVERNMENT OPERATIONS
SUBCOMMITTEE ON EMPLOYMENT, HOUSING AND AVIATION
UNITED STATES HOUSE OF REPRESENTATIVES

July 26, 1994

Mr. Chairman and Members of the Committee:

Thank you for inviting me here today to discuss one of the most troubling and difficult issues facing the nation today, the living conditions of the poor. HUD has the responsibility, through its public and assisted housing programs, of supplying funds to provide housing for a small portion of the poor population in this country. The continued availability and affordability of that housing is critical to fulfilling our commitment to our communities and the well being of our citizens. Between the public housing and assisted housing stock, we have approximately 4 million units. The assisted housing inventory, for which I am responsible, consists of about 1.9 million units.

When I came to HUD just over a year ago, I discovered the extent of the many problems facing HUD and FHA. Last year, shortly after Secretary Cisneros took office, he testified before congress that the most serious problem facing HUD today is the condition of the multifamily portfolio. We found that an estimated \$11.9 billion of the \$45 billion multifamily portfolio is at risk. In addition to the enormous financial problems, I found a housing stock decaying and HUD staff demoralized by scandal, years of inaction, and the inability to get a grip on itself or its resources. This administration will not tolerate the neglect, fraud and mismanagement we found in the programs. And we will not tolerate the terrible living conditions we have seen in the decaying portion of the inventory. After looking at some of the problems, the department began to think coherently and comprehensively for the first time about the extent and complexity of the problem at hand and began to lay out a four part strategy for tackling this issue. Let me give you some background on the inventory and then describe our four part strategy.

GETTING CONTROL OF THE INVENTORY

The condition of our inventory, both physically and financially, is a great concern to me. My colleagues, my predecessors, industry groups, and tenants have all appeared before the congress, before different committees, to stress the importance of preserving and maintaining this stock. While the goal is clear to all of us, the means to reaching the goal are varied, complex, and expensive. However, we, the legislative and the executive branches, need to decide on some approaches to preserving the stock and then apply the will to carry out the preservation over many years.

I want to say at the outset that the majority of assisted housing stock is in good condition, is well maintained, and has responsible owners and tenants. Unfortunately, we tend to hear about the minority of properties with ghastly problems. This association of terrible conditions and HUD housing assistance has in some instances led to the assumption that HUD is responsible for every poorly maintained housing project in the country.

We find the existence of even one decaying property to be intolerable. Nevertheless, the minority of properties in bad shape will become the majority if we continue on our current trajectory. So far, the past solutions amount to tinkering at the margins. The assisted housing inventory is in crisis. It is aging and the Section 8 rental assistance contracts are expiring. Some parts of it are severely distressed. It is in great demand, because affordability is our single greatest housing problem. And it needs new infusions of capital to repair and maintain the properties. In many ways we, collectively, act as though the profit motivations of the investors are not influenced by the world at large. The financial markets and tax assumptions have changed since many of these projects were built, affecting owners' decisionmaking. Behind all this is the fact that HUD, charged with overseeing these properties, faces serious impediments to carrying out its responsibilities and needs adequate tools to address multifaceted problems.

THE INVENTORY

The assisted housing universe is immense and diverse. It consists of housing built under several different programs which were developed during the 1960s and 1970s to address different housing problems. Some of the older programs, Section 221(d)(3) and Section 236, along with the Section 8 new construction and substantial rehabilitation programs, were designed as production programs, to increase the supply of housing available to low and moderate income people. The later Section 8 programs increased the supply of housing affordable to low and moderate income people by providing rent subsidies which enabled tenants to pay the difference between a percentage of their income and the rent needed to operate the project.

This inventory contains over 1 million units of older assisted housing, insured under old production programs like Section 236 and Section 221(d)(3). Another 940,000 units are the newer assisted, subsidized with Section 8, over 40% of which are also insured under Section 221(d)(4). This inventory serves roughly 5 million low income tenant families, 40% of which are elderly.

The department recently published a comprehensive study of the assisted housing inventory, the first of its kind, addressing not only Section 8 assisted properties, but all subsidized insured housing. It found that 30% of the older assisted inventory, those insured under Sections 236 and 221(d)(3), had serious backlogs of unattended maintenance problems. However, only 14% of the newer assisted inventory, insured under Section 221(d)(4) and largely supported by Section 8 subsidies, have such a backlog.

We found that many of the projects with physical problems had financial problems also. In fact, there was a correlation between projects which were on the edge financially or had financial problems and those with physical problems. We found very few projects that were sound financially but had physical problems. The financial condition of the property is clearly an indicator of physical problems. We are also talking about projects which are aging. Most are between 13 and 25 years old. We know that by the time a building is 20 years old, major systems need repair and replacement. Buildings cannot be expected to last forever. This has to be factored into our discussion about the physical condition of the assisted housing stock and how we intend to keep that condition, decent, safe, and sanitary.

THE PROBLEM

I would like to spend today focusing on the minority of properties which have been allowed to deteriorate and what the department is doing to deal with those properties. I would like this hearing to be a part of the on-going dialogue about the future of the assisted housing stock. We have some ideas about tools which we would like to discuss, although we are not here to make any proposals outside the normal legislative processes. We also need to stress that the number of properties in bad condition now is a small portion of the entire stock, but it is a harbinger of things to come if we fail to act to shore up and repair these aging properties.

There are a number of reasons for problems, both why they begin and why they persist. It would be best to briefly highlight the causes of distress, the effect of a distressed property on its community and then to focus on why often problems go unsolved.

- o There are owners and tenants who do not serve the projects or their communities well. In many of the projects highlighted in other testimony here today, the conditions are attributable to many causes. There are tenants who

are not model citizens, who do not leave units or the properties in the best of condition. Further, there are owners and managers who do not have skills and sometimes the desire to deal with problem tenants and the problems they leave behind. There are troubled neighborhoods where the problems of the streets creep into the properties; and troubled properties where the problems of the street creep into the units. Once a property starts leaving units vacant, those units become a magnet for every bad actor in the community.

We expect and demand that owners provide decent, safe, and sanitary housing. We concentrate on the performance of the owners and blame them for poor conditions. However, the tenants also have to bear a responsibility for their living conditions.

The administration has introduced the notion of reciprocity in its discussions with you about welfare. We have talked about tenant involvement in the public housing programs. We intend to expand the notion of tenant involvement in the care and upkeep of our assisted housing inventory. The American taxpayer pays to make this housing affordable for the residents. We can expect for this lifetime of sustenance, a degree of reciprocity.

- o Often the impact of distressed housing on the community is profound. Although not emblematic of all distressed housing, once housing becomes troubled and the resources available to deal with it are either inadequate or nonexistent, it becomes a haven for the undesirable elements of the community who slowly "take over" whole buildings, defying all who dare cross their turf. Once drug dealers and other criminal types dominate a neighborhood, the remaining residents of the community who can, leave.

Obviously, this problem is beyond the scope of the assisted housing program alone. Our rules are specific about what we can and cannot do about a property. But we are not blind to the external forces. The secretary has called for partnerships in the community to support the whole neighborhood, as well as, individual housing projects. We need a holistic approach to caring about the neighborhoods. HUD cannot act alone here. We need the states, cities, neighborhood organizations, and citizens to join in reclaiming these neighborhoods from bad elements. We also need the business community, the investors in housing, mortgage lenders, and the secondary market to be more involved with the operation of these projects.

- o The Tax Reform Act removed an incentive for owners to continue to invest in the housing. Unfortunately, our assisted housing programs were sold to investors as tax shelters. They started as tax programs, that is, the production of housing by raising capital through the distribution of tax benefits to members of a partnership.

With the clarity of hindsight, we can see the flaw in this approach. The Tax Reform Act of 1986 eliminated many of those higher benefits, retrospectively and prospectively. Capital previously invested no longer provided a tax shelter. Using the tax code to subsidize housing is not only inefficient but hides the cost of the subsidy. Ownership became a liability and many partners simply disappeared. The remaining owners have little or no direct accountability for solving problems. Often the ownership that HUD forecloses on is an empty shell with the housing project as its sole asset.

THE FIRST STEP -- DEVELOPING THE STRATEGY

The enormity of the management problems facing HUD in handling the assisted housing portfolio is overwhelming. In July 1993, two months after I came to HUD, I convened an asset management work group, a strategic planning team consisting of HUD career staff and housing industry representatives. This group solicited and received ideas from regional and field office housing management staff and industry representatives. I asked that the group develop an action plan that would target four specific areas:

- Improving organizational and administrative support for field offices;
- Reducing field office workload to allow staff to focus on asset management;
- Implementing tools for preventing mortgage defaults and assuring financially and physically sound properties; and
- Improving the management of the HUD held portfolio and obtaining enhanced tools through legislation.

Our purpose was to create an environment which promoted innovation and creativity. We wanted to break the old connections and create new ones to reinvent HUD's management of the multifamily portfolio.

The Asset Management Work Group has defined the problem, analyzed the loan specialist's tasks including the skills and knowledge required to perform them, received input from field staff and industry, analyzed the 93 recommendations for portfolio improvement received from field and industry, and developed a flexible action plan strategy which also satisfies key audit findings.

Our primary goal is to assure that the portfolio is properly maintained and managed. In order to do this, we have established the following goals:

- Focusing the existing resources on the areas of highest priority;
- Suspending or eliminating low priority programs and activities;
- Implementing new delivery systems utilizing non-HUD sources, eg. risk sharing and subsidy layering; and
- Utilizing advanced technology wherever possible.

You will note that we have combined programmatic and organizational issues in our strategy goals. We see them as intertwined. We need to reorient our thinking about the portfolio and our operating procedures in order to economically and rationally protect the investment in the portfolio.

THE FOUR POINT STRATEGY

Having developed a strategy, I would like to focus on what I see as the major implementation steps. The four point strategy consists of enforcement, repair, motivation for resident behavior, and the transformation of the way HUD does business. None of these efforts can work without resources and I want to take some time to focus on that issue -- what we are doing to more efficiently use existing resources and what we will need additionally to fully tackle these problems.

ENFORCEMENT

We are enforcing the regulatory agreements and housing quality standards for these properties. We are looking at both the financial and physical condition of the properties. There are a number of enforcement steps the department has already taken to enable it to deal with distressed properties and unresponsive owners swiftly without unfairly penalizing the residents of poorly maintained housing.

Civil Money Penalties

The HUD Reform Act of 1989 permitted us to impose civil money penalties against a project owner who violates the regulatory agreement in certain specified ways. Penalties of up to \$25,000 per violation can be imposed administratively after a hearing with an administrative law judge and other due process protections. While success would be never having a need to impose penalties, we are pleased with our progress, especially with our double damages remedy. To date, the government has

obtained district court judgments in 9 cases totalling \$16,041,140, settled 3 cases for \$2,543,152, and have 3 cases pending seeking damages of \$5,572,926.

Annual Financial Statement Contract

To help us identify diversions and to give us a better picture of the financial status of our multifamily projects, we have let a contract to systematically collect, automate and analyze the annual financial statement for each multifamily housing project. Under this contract, all of the annual financial statements of insured or HUD held multifamily projects eventually will be entered into a database. We will then be able to more quickly and efficiently identify problem projects and track the flow of money through the project. The contractors are currently entering the last three years financial statements. They have already entered over 65% of the 1993 data and are beginning to review and analyze the information. We expect them to be able to do reviews on 30% of the project statements, including all projects in the District of Columbia and Los Angeles, this year, another 30% next year and so on until all projects have been reviewed and the analyses completed. The contractors will be training field staff in financial statement analysis with particular emphasis on the identification of diversions and improper expenditures.

Formerly Coinsured Asset Management Contract – Ervin and Associates

The formerly coinsured portfolio is, perhaps, one of our most troubled and difficult. With coinsurance, the lender was expected to handle the asset management and properties were never intended to come into the HUD workload. When the program collapsed and Ginnie Mae (GNMA) exercised its rights to assign the mortgages to HUD, that set up a channel for these properties to enter HUD's workload. We had neither the staff or the resources to absorb this work. As a result, in September 1990, we contracted for asset management support services for field and headquarters staff. That contract was reissued in August 1993 for a base year and four option years, the first of which we will exercise this August.

The Ervin and Associates coinsurance asset management contract has improved HUD's abilities to spot and recover diversions. This contractor has collected over \$40 million in excess cash that was being held improperly by owners. Ervin and Associates has also identified many equity skimming and unauthorized distributions. We are currently pursuing civil and criminal actions against the violators, as part of Operation Safe Home. The key to this success has been consistent and aggressive followup with owners. Since the contract identifies fraud and abuse on a national, portfolio basis it enables us to identify similar problems that may exist in an owner's portfolio, regardless of location. This coordinated action against such owners on a portfolio basis forces the owners to recognize that they have more at risk than a single bad project.

Physical Inspections

We are stepping up our physical inspections of properties so that we can identify physical problems earlier. Further, we are citing owners for failure to meet the Housing Quality Standards as they agreed to do in their original contract with HUD. We have the option of declaring owners in technical default for failure to comply with the housing quality standards. This is certainly an option open to us and now with the changes in the property disposition legislation which makes it easier to exercise this option.

Previous Participation Clearance – 2530 Clearance

An old enforcement tool which has taken on a new emphasis is the use of the previous participation clearance and the threat of debarment. We have always required owners and other participants in our programs to submit information on their previous participation in HUD programs. The 2530 clearance, as we call it, has proven to be a useful tool in screening potential participants for their past problems. It has also served as a deterrent because owners, builders, managers planning to use HUD programs know they will have to complete this clearance and it will be checked. However, the 2530 clearance is limited to those who have previously participated in HUD programs. It does not reach those who have never participated in HUD programs and, therefore, have no record with us.

In addition to checking potential repeat participants when they apply for a mortgage or loan, we have an additional tool, debarment and limited denial of participation, for individuals and companies who have been determined to have been involved in some wrongdoing. We have stepped up the pace of our actions. In the first six months of calendar year 1994, we debarred as many owners and managers as we did in all of 1993. For participants in our programs, I want the word to get out - we intend to use this enforcement tool.

REPAIR THE INVENTORY

Nothing can happen unless we repair the physical real estate. The current deterioration affects a minority of the inventory. But the inventory is aging and will continue to need repairs and replacement. We need to recognize the need for resources to maintain the properties.

We will deploy a SWAT team to identify and correct problems in the most troubled housing. The team will consist of headquarters and field staff working together with HUD lawyers and the Inspector General's staff. They will use their skills, expertise, creativity and imagination to tackle a limited number of projects,

approximately 60 to 70, and develop plans which will restore them to physical and financial health.

In order to take control of the troubled inventory, we have asked our field offices to identify each troubled or potentially troubled project. As part of the performance agreement between HUD and the president, we agreed that we would have 1200 projects under an approved plan of action. These plans consist of all the actions needed to bring the property into good condition. As of the end of June, 950 projects have approved plans to repair and rehabilitate projects. We expect that we will exceed our goal by 10 percent. But we are not stopping with this year. Next year, more action plans will be developed for projects and the existing plans will be implemented.

As we begin to implement the capital needs assessment authority, we need to fully fund it so that we can identify the extent of the problems. In addition, we need to expand our capital repair program resources, readjust our budget methods for applying the annual rent adjustment factors, deal with the tax issues arising from trying to remove owners from the properties without going through foreclosure.

Example – Roxse Homes

I would like to pause here and give you an idea of how complicated and difficult it is to take action against one of these troubled projects. I have chosen Roxse Homes in Boston, Massachusetts, because we have finally come to a successful conclusion. But it took twenty years!

Roxse Homes is a 364 unit development scattered over 13 sites in the Roxbury neighborhood of Boston. It was built in 1972 by a nonprofit corporation made up of local ministers using the Section 221(d)(3)BMIR program. That program has since been repealed, but it was intended as a low and moderate income program where the rent was affordable because the interest rate on the mortgage was subsidized. From the beginning, it was in trouble. On August 1, 1974, Roxse Homes, Inc., the owners defaulted on the mortgage, and a year later, the project was assigned to HUD. There were numerous efforts at formulating a workout; all failed. By 1981, HUD was recommending foreclosure, but the owners made additional efforts to work out their problems. There was an attempt to transfer ownership, but that failed. Then the lawsuits began -- the Boston Redevelopment Authority filed suit to stop the transfer, the owners filed bankruptcy, and the courts became involved in the back and forth management and ownership of the project. On April 28, 1994, over 10 years from the time HUD requested the department of justice to initiate foreclosure, the judge finally issued an order of foreclosure. HUD finally purchased the property at the foreclosure sale on June 17, 1994.

But this is really the beginning of the story. Because now the property is in the hands of the Massachusetts Housing Finance Agency (MHFA) which will finance the rehabilitation and sale of the property. MHFA is the first state housing agency to participate in our risk sharing program which will allow housing finance agencies to originate, underwrite, and close multifamily loans which HUD will insure and share a percentage of the risk premium income. We have the support of the residents of Roxse homes in this venture who will participate in the decisionmaking. MHFA will be able to assure that the rehabilitation will be of high quality using cost effective approaches to providing funds for the rehabilitation and operation.

What Is Possible

With time, effort and resources, we can turn projects around. Properties in terrible condition can be repaired and rehabilitated and the management can be changed. The General Accounting Office has presented a video showing several properties with serious physical problems.

Let me tell you what we have been able to do with two of those properties given the resources. The first is Holiday Lake Apartments in Pompano Beach, Florida. We forced a change in management, invested \$750,000 in flexible subsidy funding and had the owner invest another \$300,000. We added more Section 8 funding and released funds from the replacement reserve. The project is now being turned around. The second is 6000 South Indiana in Chicago where we approved \$1 million special rent increase under Section 8 to finance capital improvements. The money is going to refurbishing all the units, replacing countertops, kitchen cabinets, and plumbing fixtures. We are repairing the roof and replacing all the windows. All the work should be done by Christmas. The management company was replaced. Further, we awarded a \$200,000 drug elimination grant for improved security and to close down a drug bazaar in the lobby.

RESIDENTS -- THEIR ROLE AND RESPONSIBILITY

We need to recognize the role of the resident in the preservation of the property. Residents have to be both supported and responsible. For residents who need service, we need to expand the reach of service coordinators and providers.

Service Coordinators and Providers

In our management of elderly housing, we have discovered that service coordinators are a critical component of a management team which assists frail residents of a project access the supportive services they need from the general community. We have found that this prolongs the ability of these people to live in the community and keeps them out of expensive nursing homes. But we have found that

service coordinators are no less valuable in family projects where they can link residents to needed social services, job training, and education. The National Affordable Housing Act established service coordinators as an eligible expense under the Section 202 program. We need to expand the availability and the eligibility of service coordinators in our family projects.

We also need to encourage owners and managers to reach into the community to find social service providers who can help residents of assisted housing. This has to be a cooperative effort with providers, local governments, owners, and resident organizations.

We have examples of projects where social services are available and where it makes a difference. Not very far from here, in southeast Washington, Atlantic Gardens now has a day care facility, a child learning center, and a special summer program for young people in cooperation with the police department. This helps parents look for jobs and strengthen family life. Services of this kind need to be a part of all our assisted housing.

Demographics

We must also change the demographics of assisted housing. In the 1980s, when projects ran into financial trouble, HUD provided additional Section 8 assistance. What seemed like a good way to prevent defaults had an unintended side effect. Projects which had a range of low income tenants and some moderate income tenants changed. Because of the eligibility requirements for Section 8 assistance, the tenancy became poorer. The higher income residents, the working poor, left these projects and the concentration of tenants on public assistance increased. What is wrong with this picture? In an environment where the majority are on public assistance, there are no role models who work to emulate and no network to help people find out about available jobs. As with public housing, the good intentions of the past have resulted in concentrating the least able, the poorest, and the disheartened. This is a pattern we have to change.

In addition, we have to involve residents in the management of the projects. We have successful examples of resident involvement which has turned around management and maintenance of projects. But most of all, involved residents with pride in their homes are the best guarantee that the properties will not be destroyed. The actions of the few, the bad apples, who spray paint graffiti, dump trash, and, in general, make the property unattractive destroy both the morale and the homes of the many decent law-abiding residents. We are trying to do our part, with programs like the drug elimination grants, but we need the cooperation of the majority of residents. They have a responsibility to themselves to keep their homes in good order. We justifiably blame the landlord for failing to make repairs, but we have to recognize that

the tenant who fails to report a repair or who countenances any destruction of the property is just as much to blame. There is a reciprocity and a responsibility.

TRANSFORMATION -- CHANGING THE WAY HUD DOES BUSINESS

HUD needs to change the way we do business. That is a twofold process. We need to look at administrative policies, like how we handle owner advances. We also need to look at our human resources, our staff, and how best to develop and deploy their talents. Most of all, we need to look at where we want to go and how we intend to get there.

Multifamily Note Sales

We plan to offer significant portions of our multifamily HUD-held notes for purchase at competitive sales, beginning this fall. In addition to raising revenue, this action will inject a new dimension into loan servicing and will free up HUD staff resources previously committed to servicing those projects so that they will be able to work on other projects.

Supporting HUD Staff

A well trained staff who understand the job and its importance is one of the best investments we as a department can make. We are taking steps to improve the staff complement and skills. We are augmenting our existing staff with long term temporary employees and we anticipate increasing the number of permanent positions in the field offices. We will be hiring more than 80 people in our field offices specifically to increase the resources available for our asset management efforts.

A major initiative is the Housing Technician Training Program. Under this effort, 57 Housing Technicians recently completed the final step in a concentrated training program, including on the job training in HUD asset management, in-house training in various technical disciplines, self taught courses, university level classes and training sessions taught by such organizations as IREM, Institute of Real Estate Management, and Quadel.

We are also using technology to help us communicate more effectively with field staff so that they know the latest information and have the benefit of the latest policy decisions. Among the techniques we are employing to do this is an in-house bulletin board accessed through our E-mail system, allowing us to quickly put out notices of Federal Register publications of importance, new policy memos, and instructions to all staff. With over 80 field offices, we have found that the E-mail information has preceded the hard copy publications, significantly reducing policy information gaps. We are also using teleconferencing as a training and information

dissemination tool, allowing us to reach more field staff at less cost. It also allows us to do it more frequently so that staff is continuously involved in the latest technical and policy thinking.

Field Reorganization

We are currently engaged in an extensive and important reorganization of our field staff. We are eliminating the regional offices, thereby reducing a layer of the organization and allowing field managers to report directly to me. Field offices are being given more responsibility for managing their programs and resources. They will be able to make more of the day to day management decisions directly rather than having to go through other layers of the organization. This reorganization is designed to instill top to bottom accountability for program delivery, provide more customer oriented and user friendly services, and allow us to keep pace with changes in the financial services community.

While this reorganization might not appear to be directly related to the topic before us today, I believe that increasing the flexibility and accountability of HUD managers in the field will give them the freedom and discretion they need to pursue diversions of funds. The reorganization is intended to make the most of our limited staff resources and provide those closest to the projects with the power to make the necessary decisions. This will improve our ability to catch problems early.

Policy Changes -- Owner Advances

As an example of some of the policy changes we are considering, the Department is also seriously considering a major revision to its policy on recovering capital advances made by partnerships to address serious or emergency needs not met by normal planning and funding mechanisms. Currently, an owner who advances capital may not recover it until the project is in a surplus cash position. Some of the most troubled projects which require large capital advances may never be in a surplus cash position. This in turn provides a negative incentive to owners otherwise willing to contribute cash to solve a project's financial or physical problems--those projects where the capital is most needed. If an owner recovers capital advances before the project is in a surplus cash position, the Department considers that a diversion, subject to our formidable arsenal of enforcement tools.

This blind mechanism actually discourages exactly what we want owners to do: infuse new capital into projects when it's needed. To obtain infusions of capital we must create a policy which allows owners to recover it over time, perhaps with interest, as a recognizable cost of doing business--whether or not the project is in a surplus cash position. Encouraging rather than tacitly discouraging capital advances should help us prevent the kinds of incidents we have all seen on the A&E Network

and will redirect our enforcement efforts toward bona fide fraud and inattentive owners.

FHA and Its Future

If there is one problem even more acute than the condition of the housing and the lack of tools with which to deal with it, it is the problem of FHA itself, an organization which has not been able to change with the times or adopt new technology to support its mission of providing housing opportunities which are unmet by the private sector. If there are to be solutions to the Federal government's ability to deal with the kinds of housing problems we have discussed here today, then the solutions have to start with the agency charged with that mission.

We are in the process of re-examining the role of FHA through a series of forums around the country. We are asking HUD customers and partners -- the residents, housing advocates, housing providers, builders, realtors, mortgage bankers, the secondary market, and state and local governments, as well as HUD employees -- their vision of the future FHA. From this, we hope to gather some ways in which we can remove the barriers to partnership and redefine the FHA's role in the housing industry.

We know some of the problems and we expect to learn more, but we need to work together for some of the solutions.

RESOURCES

Critical to our four part strategy are the resources to implement it. We are working smart, for example, using technology and contracting to analyze the financial statements, thereby freeing up staff to work on the more critical projects. However, nothing happens without the resources to do it. Without new resources, we cannot repair the buildings and make them decent, safe, and sanitary places to live. We need legislation to give us teeth for our enforcement effort. We need the staff to carry out the responsibilities for maintaining the inventory. HUD and the congress must address these issues together.

We recognize the troublesome fact that FHA lacks the capacity in many instances to deal with distressed properties. And we lack the programs needed to solve problems and prevent them from recurring.

- o FHA lacks the basic tools for dealing with distressed housing. FHA's model program, Flexible Subsidy, has long been underfunded and undervalued. For instance, the FY 1994 budget for public housing modernization was \$3.4 billion. FHA's budget for Loan Management Set Aside, and Flexible Subsidy combined

was around \$260 million, not counting the \$100 million special supplemental appropriation for earthquake assistance in Los Angeles. Further, Flexible Subsidy is a program which is funded largely out of the Section 236 "excess income" account. While making Flexible Subsidy a "pay as you go" program, and therefore fiscally wise, these funds are in very small supply compared with the demand, requiring that they be supplemented through appropriations.

- o Loan Management Set Aside (LMSA) Section 8 was the tool of the 80's. When markets could not support low and moderate income tenancy (basically above 50% of the area median income), HUD often alleviated vacancy problems with LMSA. This was fine for stabilizing cash flow and keeping projects financially stable and repaired, but produced, in concert with the Federal preferences, a tenant body with income at the lowest of the low.
- o The Federal preference rules, initially intended to address the needs of the very poor, has contributed to the malaise of the inner city and FHA assisted housing. These apply to 70% of all new units and vacancies in the Section 8 program. Where a property is predominantly Section 8 the preferences drive down the average incomes of the tenant body and attracted the poorest of the poor along with the social pathologies that accompany high concentrations of very, very poor people. For instance, in one neighborhood here in Southeast Washington, the average income of 1,600 Section 8 tenants living in assisted housing is 14% of the area median.

The application of the Federal preferences underscores yet another disparity between the treatment of public housing and FHA assisted. The preference rules apply to only 50% of public housing vacancies, but 70% of assisted housing.

- o Currently, owners transferring their properties to new ownership, with new capital and renewed commitments to the extension of low income housing affordability, incur substantial tax liabilities. As a result, the owners' tax consequences become the driving force in the decisionmaking rather than best interests of the residents and the taxpayers. Consideration should be given to alternative ways of addressing this problem and their cost and benefit.
- o The Annual Adjustment Factor method of adjusting Section 8 rents uses a formula for calculating the adjustment. The resulting calculation does not always set the rents at the precise amount the project needs. Some properties receive more than they need. Others do not receive enough to operate successfully causing cash flow deficiencies which inevitably result in poor maintenance and the potential for substandard housing. Consideration should be given to creating the ability to switch at HUD's discretion between applying the annual adjustment factor or the budget based methodology in evaluating

annual rent increases for Section 8 New Construction and Substantial Rehabilitation projects. This will help avert cash flow deficiencies on AAF projects where unusually difficult management problems arise. Cash flow deficiencies inevitably result in poor maintenance and the potential for substandard housing.

Creative Solutions to Difficult Problems

There are a number of things that can happen and happen immediately if a number of important legislative initiatives in this year's pending reauthorization bills are acted on. Passage of any and all of these initiatives will further expand HUD's ability to deal more effectively with bad owners and poorly maintained properties.

I began this testimony by saying that HUD needed your cooperation in providing us with the tools to make our efforts to eliminate the improper diversion of funds from our projects. There are some areas the executive and legislative branches should jointly consider:

- When HUD recaptures Section 8 subsidies for violations of HUD requirements, the recaptured budget authority is returned to the treasury. Subject to appropriations, this budget authority could be used to fund another project based contract or be converted to a tenant based subsidy such as vouchers. Therefore, HUD could take enforcement actions without reducing the supply of decent, safe and sanitary housing available to tenants.
- Although the property disposition legislation passed earlier this year went a long way, the Department still seeks to regain its lost authority to be exempt from bankruptcy stays when owners attempt to avoid foreclosure by hiding behind the protection of the bankruptcy courts.
- There currently exists no capital grant repair program which can be targeted at any assisted property with or without mortgage insurance. We have found that, in the absence of other capital funding tools, lack of such a repair program leads to further deterioration of the properties.
- Expansion of Civil Money Penalties in the Senate bill (S.2049) to include identity-of-interest managing agents and owners who enter into Section 8 contracts without mortgage insurance.
- Fully funded Capital Needs Assessment authority needs to be expanded to Section 8 properties, especially in advance of the contract expiration and potential renewal.

- Expand the "shallow rental subsidy" concept in §601 of the Senate bill to all applicable Section 8 programs.

CONCLUSION

The question remaining is whether any of these actions alone or in concert will stem the tide of trouble in the assisted housing portfolio. I am optimistic that given the resources they will. There are added ingredients needed, however, and they are time and will. Even with the resources, it will take time to repair the real estate. We need to plan on two to three years from start to finish on repairing a property. And we need the will to stay the course. Because of the long time frames and the extent of the resources needed, there must be a partnership and a commitment among the legislative, the executive, the owners, and the residents of these properties to improve these properties and maintain them as decent affordable housing.

If the resources and the commitment are not forthcoming, the inventory will continue to deteriorate. In five years, my successor will be here before you again answering the same questions and looking at the same pictures. Only then, the inventory will be five years older and a larger portion of the properties will be as distressed as the ones we saw today. We have to take a stand and it must be now.

Mr. PETERSON. Thank you, Mr. Retsinas. We are going to have to adjourn here while this joint session takes place, so we would request that you would stay around so that we can ask questions because it will be about 45 minutes, but—maybe you could think about this.

I tell you, the more I hear this, I really question, I mean I understand what you are getting at, but I have a real question of whether we should even continue this program. I have to tell you that even if we gave you everything that you asked for, I am not so sure that this whole concept isn't fatally flawed because we get sucked into this and we can't get out. And so one thing I would like to know that I haven't had time to track is whether you are now starting any new projects in this area. In other words, I know you are not building anything new, but are you putting money into a troubled project and getting them hooked into this system that wasn't there before. Could you provide us with that information.

Mr. RETSINAS. I would like to address both questions.

Mr. PETERSON. We will recess here for about 45 minutes or however long it takes, and then we will resume questions when we get back.

[Recess taken.]

Mr. PETERSON. I call the subcommittee back to order. My colleagues will be here shortly.

Mr. Retsinas, I was listening to your plan, and I guess I have some questions about whether this particular program can be salvaged. Are you now committing any new project-based Section 8 assistance to projects that don't have them at the present time? Is that happening or is it only being used to salvage existing situations and address problems?

Mr. RETSINAS. Let me answer that question as specifically as I understand it, Mr. Chairman, and I would be happy to elaborate as you would like.

On the narrow point of are we authorizing or allocating new Section 8 project-based units with one exception, generally, the answer is no.

The exception is a new initiative authorized by the Congress last year that allows us, in cases where we can find pension fund investors who, as I am sure you know, are particularly conscious of their fiduciary responsibility, in those cases we have the authority to allocate new Section 8 project-based assistance. As a matter of fact, we will be announcing those initial awards within the next 30 days or so.

Mr. PETERSON. Pension funds would own these projects?

Mr. RETSINAS. Pension funds would be the investors. They would generally work through intermediates.

In some cases, they might be housing finance agencies. In some cases, they might be community-based nonprofits. In one of the cases they will be working with the government-sponsored enterprises, Fannie Mae and perhaps Freddie Mac, but they would be the investors in these projects. It is a way of getting more resources into affordable housing.

Mr. PETERSON. How big of an equity position would they have to take?

Mr. RETSINAS. The pension funds would be debt investors.

Mr. PETERSON. Where would the equity come from?

Mr. RETSINAS. Again, they would be using local intermediates. They would be working with local sponsors. For example, the AFL-CIO is a major pension fund investor. They would be working with sponsors in various communities throughout—

Mr. PETERSON. Would they be nonprofits?

Mr. RETSINAS. In many cases, yes.

Mr. PETERSON. Would they be private?

Mr. RETSINAS. They could be. Generally speaking, the proposals we have seen tend to be favored or biased toward community-based nonprofits, which I think is healthy.

Mr. PETERSON. Are these going to be any better managers than what we have seen under the existing situation?

Mr. RETSINAS. I believe so.

Mr. PETERSON. Why?

Mr. RETSINAS. We believe that these particular investors of pension funds have a special responsibility to ensure the adequacy of the assets that they own.

Mr. PETERSON. Are you insuring these?

Mr. RETSINAS. In some cases, yes, but in most cases, no.

Mr. PETERSON. Well, then if you are insuring them then they are going to be too worried about their fiduciary—

Mr. RETSINAS. In almost every case we will not be insuring. The insured will be a small minority. This is essentially a noninsured program.

Mr. PETERSON. Why wouldn't you insure?

Mr. RETSINAS. In some cases we may be working with a local housing finance agency where we have entered into a risk-sharing program. But they will be very much a small minority.

Mr. PETERSON. Maybe we could have this discussion in my office. That might be constructive.

One of the things you asked for was more financial assistance that you could put into these units to try to, apparently, to upgrade the units and do repairs. At the present time, do you have any additional authority that you have been able to acquire that you have been utilizing to shore up some of these units or not?

Mr. RETSINAS. No. In this particular case, we have used the authority we have. Some disbursements, of course, have not been made because they track the actual repairs. But, no, we have run out of authority. The demand far exceeds the supply of funds that are available.

Mr. PETERSON. But there has been some authority which you have used in some cases in the last—

Mr. RETSINAS. There has been a small program called the Flexible Subsidy Program as one example.

Mr. PETERSON. How many dollars is that?

Mr. RETSINAS. I think last year was \$111 million.

Mr. PETERSON. And then you go into these projects that are having trouble and you give them some additional—

Mr. RETSINAS. We give them assistance often in the form of a subordinated mortgage that would allow them to make the necessary repairs.

Mr. PETERSON. How do you determine where to put this money if you don't even—we have had testimony that we don't have basic

information about these projects. Is this for particular units you have identified?

Mr. RETSINAS. If we had enough money what I would like to do is a better inspection system. Right now, we do it through a competitive process we have something called a notice of fund availability that says these funds are available. On the basis of need and ability of the sponsors to use the funds we award the funds.

Mr. PETERSON. And they have to make repairs if they get these flexible funds?

Mr. RETSINAS. Absolutely. Absolutely. That is an absolute requirement, Mr. Chairman.

Mr. PETERSON. Do you make sure they do that?

Mr. RETSINAS. Oh, sure. We check as part of the certification of their expenditures, yes.

Mr. PETERSON. Do you—have you checked on this either—

Mr. GREER. We have not done any audits of the flexible subsidy program in quite some time. The last one was in 1988.

Ms. ENGLAND-JOSEPH. The question that you might want to ask is how the owner pays back that flexible subsidy. How does that owner pay it back? It is a loan versus a grant? I am not really sure of what you are talking about, Nic, how much of the \$120 million is grant versus loans.

Mr. RETSINAS. It is all in the form of loans—if I may.

Mr. PETERSON. Yes. That is what I wanted to understand.

Mr. RETSINAS. I wanted to follow protocol, Mr. Chairman, if that is fine.

Mr. PETERSON. It won't bother me.

Mr. RETSINAS. They are all in the form of a subordinated note. Some of the terms are so—and I will use technical jargon, if I may—soft. That is to say, the terms are such that an outside observer may say it is a grant because there would effectively over time be a low likelihood that there was cash-flow to repay it.

But it all has some debt relationship through some kind of a residual receipt note or some kind of note that secures it. Though it is—in the more troubled projects the likelihood that that payment would be accelerated and would be early is not high.

Mr. PETERSON. Now if I understand part of what you are saying here is we might have a situation and it could be due to the tax law change. We may have examples of a property that has got a rent that is, say, twice or maybe $1\frac{1}{2}$ times what it is in that area and it is in a troubled situation.

And so what you are saying to us is that you, in order to fix this, we were going to make available some additional money, and we are going to go in and even raise the rent beyond that. Is that what I heard you say?

Mr. RETSINAS. What you heard me say is that I can envision situations—although they are a minority—where the rents need to be increased.

Mr. PETERSON. If they are double than what they are.

Mr. RETSINAS. Not necessarily if they are double the local market rents but there are situations where the project rent exceeds the market rent. If there is a commitment to provide necessary social services in the absence of a capital assistance program, for exam-

ple, or a more flexible subsidy program we do not have a more efficient way of making those changes.

If I could elaborate with some examples.

Mr. PETERSON. Go ahead.

Mr. RETSINAS. Thank you, Mr. Chairman.

There are situations where it would be cheaper for the government to make a front-end investment, a capital investment; but because there are no funds available, often one has to increase the rents. In doing so, you also incur a financing cost in addition to the actual costs. That is why we are calling for, at least your consideration of, a more flexible capital program that would allow us to make more surgical forms of assistance.

Mr. PETERSON. Why are we doing this? Because we have insured the mortgage and if we don't bail this property out, we are going to end up stuck with the mortgage? Is that why we are doing this? Or are we doing this to protect the tenants? Why are we doing this?

Mr. RETSINAS. A little bit of both. Each situation is different. In some cases, we have contractual responsibilities. In other cases, we have a stewardship over the properties. We need to ensure, as I pointed out in my testimony, that residents in taxpayer-assisted developments have safe, decent, and sound living conditions.

Mr. PETERSON. I understand that, but you are not doing that now.

Mr. RETSINAS. We are doing a little bit, but we would like to do a lot more.

Mr. PETERSON. I understand, but the reality is that we are not doing it. On a lot of this property we are not providing good, safe, affordable housing.

Mr. RETSINAS. In many of these properties, we are not. That is why we have asked for the additional tools.

Mr. PETERSON. I understand, but I think it is very unlikely, given the track record of this program, that you are going to get the Congress to give you more money to do this—either in this request that you have for more people or additional rent subsidies, whatever it might be. I think it is very unlikely that the money is going to be there.

I mean, the whole focus of this Congress is to cut the deficit, not to find more ways to spend money, you know. So how realistic is this? I understand what you are saying, but I have some questions about whether it is going to happen.

And, second, I have some real questions about whether we ought to be in this business because we are not doing a very good job and we end up getting stuck with this and basically put in a catch-22 because we are concerned about the tenants. And would we not be better off to bite the bullet, if you will, and just terminate this and switch the subsidy to a tenant-based subsidy and let the market take its course? Have you looked at that?

Mr. RETSINAS. Yes.

Mr. PETERSON. What do you think about that option?

Mr. RETSINAS. In terms of your general comment about how realistic and plausible additional resources are, you are a better judge of that. I can't disagree with your assessment. I just wanted to give you an honest assessment that this is the job we want to do. This

is what it will cost. I owed that to you, and that is what I gave you.

Mr. PETERSON. I appreciate that.

Mr. RETSINAS. Thank you.

On the matter of the tenant based, let me give you an initiative we took last year, and let me be candid about the reservations that were expressed about that initiative. I think it relates exactly to your larger question. What is the continuing responsibility of the department and the government to provide affordable housing and is this the best way to do it?

Last year when I began, 13 months ago, one of the immediate problems that was clear and visible to me were the restrictions in the disposition of housing that was owned by the Department—that is, housing that had passed the pale, housing that we had foreclosed and taken over.

It was also clear to me that in those situations there are opportunities for us not to repeat the mistakes of the past, not continue to fund housing in inappropriate conditions; not continue to fund high concentrations of poor people.

We proposed some substantial relief from those restrictions, relief that would allow us to convert those project-based subsidies into tenant-based subsidies.

As our legislative initiative made its way through the Congress, time and again we were told to reduce that discretion. The arguments were to continue the subsidies where we wanted to argue in some situations it is more efficient to turn to vouchers.

On the larger question, if we were to design the program today, if we had the one thing that we haven't asked you for: the authority to turn the clock back and redesign the programs, we wouldn't design yesterday's programs knowing what we know today. We would design programs that would, in part, be production programs because there are some housing markets where the needs are so great, the gaps are so deep, that with any voucher program, there would be no place for people to live.

In other housing markets where the need for new units is not so great vouchers afford that kind of flexibility.

We certainly would not have designed a program that exclusively relied on tax benefits, benefits that were taken away over time.

The difficulty, Mr. Chairman, is not the design of new programs. I think the harder question is what do we do with the stock we have now and the people there. If we could start with a blank slate, then I think all options ought to be open.

The reality is we have all inherited the conditions we have now, and how we deal with that stock and those residents and that obligation is a real challenge.

Mr. PETERSON. Do we know how much of this troubled housing has government-guaranteed loans behind it and what the potential exposure is that if we just cut this off and all of this defaulted and we ended up with all this property back?

Ms. GAFFNEY. About \$7 billion.

Mr. RETSINAS. We have \$45 billion of insurance in force right now.

Mr. PETERSON. Are all these troubled?

Ms. ENGLAND-JOSEPH. Not all of those are subsidized.

Mr. RETSINAS. No.

Mr. PETERSON. That is what I am getting at. Do we know that number?

Ms. ENGLAND-JOSEPH. The percentage of the \$45 billion that is subsidized?

Mr. PETERSON. Well, that is tied to this project-based assistance that are in trouble.

Ms. GAFFNEY. Let's try it this way. Of the project-based Section 8 how many are insured?

Mr. PETERSON. Right.

Mr. RETSINAS. Forty percent.

Mr. PETERSON. How many of the ones that are insured are troubled? Do we know that information?

Mr. GREER. I think, Mr. Chairman, rough estimates would be somewhere in the neighborhood of 25 percent, based on the loss reserve figures that were established in the most recent FHA audit. So if you took 80 percent, which is the rough equivalent of what Nic just said was Section 8—you took 80 percent of the \$10 billion dollars, you would be somewhere in the ball park I think—\$7 or \$8 billion at risk.

Mr. PETERSON. That would be the hit that we would take if we did what we needed to do and that would cause the whole thing to collapse and we dealt with it.

Mr. GREER. That is an estimate. Current loss reserve established by the FHA.

Mr. RETSINAS. That is an estimate, of course, which I am not going to quibble with. That is the financial cost. There are still residents.

Mr. PETERSON. I understand.

Ms. ENGLAND-JOSEPH. The other thing we have to remember, in the case of Chicago property that we have talked about earlier, the hit has already been taken. The claim has been paid on that note, and now it is a HUD-held note. So we are talking about not just the estimated \$7 billion of the current insurance in force portfolio but an additional percentage of properties that are HUD-held that would also be a part of this problem.

Mr. PETERSON. I imagine the other side of this problem is there aren't a whole lot of folks just looking to get into this business right now because there are no tax credits, there is no profit incentive to, you know, say take over one of these defunct properties and go in and rehabilitate it and make it into a workable deal, I imagine. Is that not true?

Mr. GREER. It is not quite as lucrative as it was back in the late 1970's and early 1980's, that's correct.

Ms. ENGLAND-JOSEPH. Although hasn't HUD experienced just in the property disposition process over the last 6 months some success—a great deal of success in selling off those properties?

Mr. RETSINAS. Well, more, certainly. Certainly, the legislation helps. The good efforts of Ms. Dunlap and her colleagues are helping. As I said, things are getting a little better but not quickly enough, and the problem is still too deep. But they are getting better, Judy.

Mr. PETERSON. Do we know who has been buying these properties? Does anybody have that information? So—I mean, if things

have picked up and people are starting to get back into this, do we know who these people are and do we know what kind of track record they have? Are these people that actually know what they are doing or are they more problem folks?

One of the problems with the tax credit situation—people that got in it for tax benefits, they didn't want to be in the housing business necessarily. They weren't any good at it.

Mr. RETSINAS. Right.

Mr. PETERSON. And you know that is part of what we are dealing with right now.

Mr. RETSINAS. That is true.

Mr. PETERSON. And so I think we have to be careful that whatever we do that we get people into this business that know what they are doing and want to be in this business and are going to manage things.

So if you could get me that information, if we don't have it, I would appreciate it.

Ms. DUNLAP. I think I can give you a general overview.

First of all, to the extent that we are seeing a change in ownership.

Judy just mentioned property disposition. Let's deal with that first. In property disposition, which are the properties we have taken into inventory because they were so bad that there was a need to take it in either from a financial standpoint or a physical standpoint and then we have resold, most of those we are reselling, to the extent we can resell them without restrictions, we are selling without insurance.

But those with restrictions and those Section 8's that are now acquired under the property disposition law, are being purchased by for-profit owners who are interested in cash-flow. There is no question that they are counting on that Section 8 as a portion of that structure, and that is what the law requires.

Mr. PETERSON. And this is—

Ms. DUNLAP. That is project based, which is what the property disposition law requires. To the extent we can sell them without restrictions and/or Section 8, in many cases they are being bought by small local investors.

Mr. PETERSON. I guess that was my question. If the project base didn't exist, if that wasn't there and you tried to sell them, you would have a difficult time.

Ms. DUNLAP. Right. If project based doesn't exist, we have two groups of ownership that we are seeing. One is for-profit owners who are interested in owning unrestricted multifamily housing, and the second are local nonprofits and resident groups, who are definitely the No. 1 growing group of interested parties in our stock—not just the stock we are disposing of but also stock that is transferring from one ownership entity to another.

We have a lot of local governments that are taking on the responsibility for playing a major role in that new ownership structure. Some of them count on the Section 8 as part of that; some of them don't.

Mr. PETERSON. Mr. Retsinas, you proposed some changes in the laws to make sanctions more effective and so forth and so on. Why

haven't you been more aggressive in using your existing sanctions up to this point?

I am somewhat skeptical when I hear that you have never—there has never been civil money penalties assessed against an investor and owner. Even if we give you more authority—you moved against the lending institutions, apparently, but I guess, if you have never moved against an owner or a manager, what good is it going to do?

Mr. RETSINAS. We have moved against an owner, Mr. Chairman.

Mr. PETERSON. With civil money penalties?

Mr. RETSINAS. Yes, we have.

Mr. PETERSON. How recent and how often?

Mr. RETSINAS. We did it with a major owner.

Ms. DUNLAP. We are applying it today as frequently as we have cases that we feel are enforceable. We have collected in the Northeast on two major ownership structures since we began using the tool last fall, one for \$500,000 and one for \$1 million.

Mr. PETERSON. Was that—the first time was last fall?

Ms. DUNLAP. The first time when we started using it was when we arrived, basically, and were able to document cases that were enforceable. We are considering using it more actively as we move forward. It is a tool that, prior to our arrival, was not being heavily used by the department.

Mr. PETERSON. Ms. Gaffney, do you agree with what she said?

Ms. GAFFNEY. I think when we are talking about civil money penalties we are talking about a specific law and a specific type of administrative hearing, and I am not sure. We will have to work this out.

But in Mr. Retsinas' statement, for instance, it seems to me that some of the information under civil money penalties is actually double damages through settlements and judgments, which is not the same thing. But to my knowledge—and my knowledge is based on talking with the lead enforcement attorney in HUD—there have been no civil money actions against owners as such, but we are going to have to, obviously, work this out.

Mr. PETERSON. Well, you do that.

This issue of the Section 8 having a higher rent than the comparable rent, that is against the law, right?

Mr. RETSINAS. Section 8 rent is—excuse me, I am not—sorry.

Mr. PETERSON. It is not supposed to be significantly higher than the comparable rent in that area. Is that the law?

Mr. RETSINAS. That is a law except that we also have contracts that have to be honored. Over time, the Department has tried to increase its discretion to lower rents, and there often have been situations where that has not been possible.

Mr. PETERSON. So you ignore the law.

Mr. RETSINAS. No, we don't ignore the law. As a matter of fact, we are in the process now of—

Mr. PETERSON. But, apparently, you were supposed to be doing comparability studies and that in 1989 you were directed to issue regulations, and they still aren't out.

Mr. RETSINAS. Yes.

Mr. PETERSON. Well, you weren't, but HUD was.

Mr. RETSINAS. HUD was, right.

Mr. PETERSON. They are still not out. You have been there a year.

Mr. RETSINAS. Thirteen months.

Mr. PETERSON. And we still don't have them.

Mr. RETSINAS. Well, rather than do comparability studies what's important is bringing the rents under control. And what we have come up—

Mr. PETERSON. Have you reduced the rent for any of these projects.

Mr. RETSINAS. Yes, we have.

Mr. PETERSON. How many?

Mr. RETSINAS. I don't know.

Mr. PETERSON. Can you get me the information?

Mr. RETSINAS. Absolutely, Mr. Chairman. I would be happy to. Absolutely, Mr. Chairman.

[The information follows:]

HUD provided a list of 321 projects in which contract rents had been reduced by refinancing the HUD-insured mortgage, rather than as a result of a comparability study.

Mr. PETERSON. Have you—are you aware of them reducing rents?

Mr. GREER. I am not personally aware of a situation. That doesn't mean that they haven't happened. We are aware that comparability studies are not being done because the regulations are still not out.

Ms. GAFFNEY. Could we pursue that point? Because I truly do not know where they stand.

Mr. RETSINAS. Rent reductions, Helen.

Ms. GAFFNEY. Not in the rent reductions but in the regulations.

Ms. DUNLAP. We began meetings with representatives of the IG's office relating to this matter last fall. We agreed to an alternate plan which we feel will allow us to reduce rents in a fashion that will not require extensive staffing to do comparability studies, which would then be tested in court. That plan has been to change the method by which we increase rents. Rents would be based on the operating expenses of those properties, rather than the marketplace. This will allow us to be sure we are supporting the rent the project needs but not more than the project needs.

Mr. PETERSON. You are arguing then that we have got situations where we are paying more rent than we should and we have to put more money in to bail them out. And I have to tell you in your public housing program where, apparently, they have to bring in a budget in order to get funding—I don't know what they call that program, but they have got these projects that are owned evidently by HUD and you give them an operating budget.

Mr. RETSINAS. I am not sure of the name.

Mr. PETERSON. I am not impressed with the way that works. And if this is going to be like that—I have seen when HUD gets involved with setting budgets what happens, and I am not particularly impressed. We are probably going to have to have a discussion in my office some day to get at some of this stuff.

There is one other issue I wanted to pursue and then Mr. Zeliff can ask some questions. This discussion about having enough staff and developing the data systems and all of that. I mean, I understand that, but, frankly, from what I have—in talking to people I

have some real questions about whether you have people in your Department that actually know what is going on with these properties and how they work. And I am concerned about that. And do you have some—

Mr. RETSINAS. Me, too.

Mr. PETERSON [continuing]. Some plan to bring people in to get rid of—I mean, I have to tell you the more I look at all these different government programs, that it almost seems like the things that we set up in the government to deal with the problem are now the problem, and the biggest trouble we have is trying to figure out how to get rid of this stuff that is in place that isn't working so we can get something in place that does work.

And I would imagine what the situation is—you have got some people in there that are bureaucrats that shuffle paper but that really don't know how the real world works in housing and the tax laws and all the other problems that are involved. So how do you get those people out and get people in if we are not going to give you any more FTEs? How are you going to do that?

Mr. RETSINAS. Well, let me answer that in two ways because your points are points that concern me greatly for the same reason they concern you. I am not sure I would use the same words, but the points concern me.

First, one of the ways we do that, I think, is by changing the way we deliver our services and products. And let me give you examples that relate specifically to your State.

As we look at the origination of new mortgage insurance, it is important for me to have a sense that the originators of that mortgage insurance do understand local situations and the need for appropriate underwriting. So, earlier this year, we signed what we call risk-sharing agreements with 27 States and 6 localities around the country that would underwrite the mortgage insurance.

Last week we initiated the first project in the country to a risk-sharing program. That was in the State of New Hampshire, Congressman Zeliff. The New Hampshire Housing Finance Agency, which is an excellent agency with an outstanding executive director, had the first project in the country.

We have signed an agreement with the State of Minnesota to also be our underwriter so that, over time, we will be able to change.

Mr. PETERSON. Do they share the risk?

Mr. RETSINAS. Yes, 50 percent of the risk.

Mr. PETERSON. What do they get out of this?

Mr. RETSINAS. One, they get affordable housing for their communities. Two, they also get a share of premiums. It is a true risk-sharing partnership that we are absolutely excited about. I think that is going to be the future.

Mr. PETERSON. So you are going to work with housing finance agencies and turn over—

Mr. RETSINAS. Having been a former director of a housing finance agency I have great confidence—

Mr. PETERSON. I have much more confidence in them than I do in HUD.

Mr. RETSINAS. I have a lot of confidence in housing finance agencies, and I have confidence in what we are trying to do.

Second, the point in terms of staff is well taken. This is a Department that not only has had a reduction of staff over in the last decade but, perhaps more significantly, there has been a freeze on hires. So the average term of employment of a HUD field office employee is over 20 years.

I would not call them paper shufflers. I think they are good, honest, hard-working individuals. In some cases they are certainly overwhelmed with the work before them. Further, over the same time there has been a continual rejection of money allocated for training and other staff upgrading.

We are paying the price for that today. That is why we are changing the delivery system, and that is why and I repeat what you heard from the GAO and the Inspector General—if we want to deal with this problem, we need people and we need trained people to deal with it.

Ms. ENGLAND-JOSEPH. I would like to add something to what Nic has just said.

The issue of resources and capacity I think is an interesting one because, on the one hand, we have said in our statement that HUD needs greater capacity, needs the kind of skilled employees in order to carry out their financial responsibilities.

But I really think it goes beyond that to an issue of what are the priorities and what are the most important actions that we think we can do given the resources that we have.

Because of the fiscal environment we are in today we have got to recognize that things are not going to change that quickly. There is a culture at HUD that for years has said we don't go after owners; we don't enforce; we don't take actions in terms of onsite inspections; we don't play the role that HUD as a property asset owner as well as manager has to play in making these properties work well.

So there is an aspect of this that I think is still within the capacity of HUD today if those priorities were clearly stated and if actions were rewarded rather than discouraged when employees come forward with evidence that would indicate something has to happen with the particular property or with a particular owner.

So while I agree that I think HUD needs resources, training, and systems, all of those things, they have the ability today to do certain things, and it is a matter of trying to figure out how you go after your worst rather than managing perhaps the whole 100 percent. Maybe you go after your—I use the 80-20 rule. You go after the 20 percentage that are the worst because that is the part that is going to cost you more money and create more problems because the 80 percent may be fine. Go after the problems that you know are going to be the most difficult and address them first.

Mr. FRICKE. If I could just add, Mr. Chairman, to what Judy just said and that goes back to a point that Nic raised earlier and that was flexibility.

I think we would wholeheartedly support the Department gaining added flexibility in terms of using vouchers or certificates in instances where properties really no longer make sense to preserve. I don't think there would be much argument today that vouchers and certificates are the most cost efficient way to house lower income people.

Nevertheless, there clearly are properties out there where vouchers and certificates won't work because the community around them—there just isn't the available housing to house the populations that are currently being housed in the assisted housing—in the assisted property.

But, again, I think the flexibility that Nic spoke of earlier is something we would wholeheartedly support.

Mr. PETERSON. Well, both of you have—Ms. Joseph, you said they use their enforcement tools sparingly and inconsistently. And, Ms. Gaffney, you said there is a culture at HUD that they won't use these tools. If I asked you to grade HUD on an A to F basis on how effective they have been using their sanctions at this point, what kind of grade would you give HUD?

Ms. ENGLAND-JOSEPH. Given the conditions that we saw—and it was easy for us to identify the 10—and granted there are good properties, so I don't want to make it sound like the entire program is a problem, but knowing that we found so easily deplorable conditions I would give them an F on the conditions of those properties and actions taken on those properties.

I probably—let me just say one more thing. I would give them a C or a C plus in the fact that they do recognize they have a problem and they are trying to figure out how to deal with that problem. But there is a long way to go before that goes much beyond a C.

Ms. GAFFNEY. F.

Mr. PETERSON. F. You give them a C plus for trying?

Ms. GAFFNEY. No, I want to be very straightforward about this. This team headed by Nic Retsinas and Helen Dunlap is extraordinarily committed and talented. And, in 1½ years, I guess it is now, they have come up with plans to address problems that exceeded the imagination. The problem with this whole—

Mr. PETERSON. Nothing has happened.

Ms. GAFFNEY. Well—but if we stay with it for years, it will happen. The trouble is that this team has how long to go, Nic?

Mr. RETSINAS. This administration and then the next one if the President is reelected; 6 or 7 more years.

Ms. GAFFNEY. But you have read what Senator Glenn has said about turnover of political appointees. So the team will change, and these efforts are multiyear, and I think they need to proceed. Someone has to have the energy to go forward with these things.

The trouble is, when a new team comes in, what happens to all of that? But, apart from that, what I am trying to say is it is not good enough to say we have long-term plans. We cannot see the kinds of conditions that GAO has shown us and say not to worry—in 5 years we will have systems, we will have staff, we will have mechanisms, we will have legislation that will enable us to address that stuff.

Mr. PETERSON. I am taking too much time.

There is one more thing I want to ask you because I understand you may have to leave, but I have been having trouble getting financial information on these projects, on these 40 percent of the properties that are in trouble. Being a CPA and having done a lot of these deals, I would like to look at some of this information and judge for myself as to what is going on here. Are you doing an eco-

nomic analysis of these troubled projects, the ones that haven't been foreclosed?

Mr. RETSINAS. Yes.

Mr. PETERSON. Do you have that information available? Can you get that to me?

Mr. RETSINAS. We do. And we will share whatever we can share. There are some things because of a proprietary nature we may not be able to, but whatever we can share, our files are open, and we would be happy to supply that to you.

[The information follows:]

HUD submitted a portion of a HUD Handbook 4350.1 "Multifamily Asset Management and Project Servicing", Chapter 11, Workouts for HUD-Held Projects. The Chapter is guidance to HUD field staff on resolving problems in projects assigned to the Department, with the objective of reinstating the mortgage.

HUD also submitted an analysis of 6000 South Indiana Avenue, Chicago, Illinois on October 5, 1994.

PROJECT NUMBER 071-55119
6000 S. INDIANA

On February 14, 1989, the Chicago Office recommended foreclosure on the mortgage of 6000 S. Indiana. On May 25, Headquarters sent the 21 day foreclosure letter to the owner, which had the automatic effect of preventing the local Field Office from pursuing further discussions and negotiations with the owner. At that time, all foreclosures were handled through Headquarters.

There were constant complaints from tenants. Legal Aid was actively involved with the tenants. The project was in dire need of repairs. The owner was very uncooperative and constantly threatened HUD staff with legal action for attempting to remedy the problems at the project. In late 1991, Headquarters returned the foreclosure recommendation to Chicago when local offices were delegated authority to now handle their own foreclosures.

An occupancy review and physical inspection completed in July 1991 revealed continued major problems with the project's physical condition. Tenant complaints were continued to mount. In August 1991, an attempt at completing a management review was made. However, the owner would not make his financial records available to field office staff representatives. Meetings were held with tenants concerning harassment by the owner. Staff continued to attempt to deal with Dr. Graham, the owner/manager, but were unsuccessful. The field office sent another 21 day letter to the owner on February 13, 1992. On February 19, the field office recommended that the foreclosure be initiated and that HUD pursue Mortgages In Possession. On April 1, regional counsel rejected the recommendation for foreclosure. It was felt that insufficient attempts were made to resolve the problems, while Headquarters was pursuing the foreclosure.

On April 21, 1992, a letter was sent to the owner withdrawing the foreclosure. The field office also provided him with the names of three reputable management companies. A deadline of May 11 was given to the owner to obtain outside, professional management. We completed a comprehensive management review on May 12. There, of course, were major problems. We gave the owner 30 days to present a curative plan.

On June 1, 1992, the field office received and forwarded a copy of a summons filed by the Legal Aid, to counsel. On June 26 another 21 day foreclosure letter was sent to Dr. Graham. In the mean time the owner submitted a curative plan. On July 17th the field office sent a letter to the owner stating that his plan was unacceptable and that HUD was proceeding with the foreclosure. The owner and his attorney met with the field office on July 28

to discuss the issues. A decision to continue the foreclosure would be made after a site visit on August 14. On September 2 the field office withdrew the foreclosure initiative. The owner had agreed to outside management and to relinquish all control over the project.

Since that time, loan management staff has worked with the manager in developing and instituting a comprehensive plan to return the project to a safe, sanitary and habitable condition. Specifically, HUD has approved a three year Management Improvement and Operating (MIO) Plan which would provide for substantial capital improvements (\$910,002), funded through a rent increase. The owner had not had a rent increase for 9 years due to his failure to submit audited financial statements. Once the financial statements were received, the rent increase was processed and approved. The additional funds generated by the rent increase are being placed into a repair escrow. Additionally, the manager submitted a Drug Elimination grant application and was successful in obtaining another \$175,000 to improve the security system at the building.

Repairs are now being made. The building is secure. The hallways are clean (used to be painted in the worst way, but that will be addressed shortly). New windows are ordered and will be installed by the end of the year in this high rise building. Kitchen cabinets in all apartments are being installed. New bathroom sinks and bathroom repairs are being made. New tile is being laid throughout. Tenant meeting space is being developed on the ground floor. The owner for all practical purposes is not involved in the project and not taking any distribution from the project. The Legal Aid has dropped HUD from their law suit though it continues to pursue civil actions against the owner.

Questions concerning owner contributions were raised by GAO when the case was discussed the case with field office staff. The owner did not come up with additional funds. He is no longer controlling the project funds and is no longer collecting a management fee. His wife is no longer employed by the project, so there was some financial consideration by the owner. However, if he had not conceded, HUD would have continued with the foreclosure. The project is still delinquent and a workout is not in place, but is being negotiated. The field office is hesitant to divert funds from the repair program at least until the major repairs are completed.

After the repairs are completed, the field office will reassess the rent levels at the project. If the rents are too high, they will be reduced.

Mr. RETSINAS. We are doing—the term we use is workouts on troubled projects. The first step on that is collecting information. I mentioned the contract now where, finally, for the first time, we are collecting financial statements on all the projects. These were not current until we initiated the project.

Mr. PETERSON. You are collecting that at the present time?

Mr. RETSINAS. Yes.

Mr. PETERSON. You don't have that?

Mr. RETSINAS. We collected 65 percent of it literally at the end of last year.

Mr. PETERSON. If you are in a troubled status or some kind of problem you can get those financial statements. They can't withhold them from you.

Mr. RETSINAS. No, they cannot.

Mr. PETERSON. So that information will be available to you. Do you agree with that?

Ms. GAFFNEY. The problem has not been getting the financial statements. It is doing anything with them, which is what that contract is intended to start addressing.

Mr. PETERSON. To some extent, we are in a catch-22. The projects have got more repairs than we've got money to allocate. The rents are already too high. We have people that aren't taking care of things and are destroying the property. You got all those other things mixed in here.

So what do you do? That is my question. I mean, my conclusion is that maybe we ought not to be in this business if we can't do a better job than we have been doing.

Mr. RETSINAS. Mr. Chairman, I hate to keep focusing on the specific, but allow me one more chance because I don't get a chance that often for people in the Congress to listen to the extent of this problem. Sometimes it is a voice in the wilderness.

We have legislation now winding its way through the Congress as it relates to the Section 8 program. In that legislative initiative we have asked for the discretion to say no to contract renewals in certain cases. I am not sure—

Mr. PETERSON. But you have not gotten through because I just came back on the subway with a member of the Appropriations Committee of VA-HUD who had seen the piece last night on the news, and they don't understand this. I mean, I don't know what is going on, but maybe this hearing will help.

Ms. GAFFNEY. What do they not understand, Mr. Chairman?

Mr. PETERSON. Well, I don't know. They had an understanding of what had been proposed and what was being talked about and—

Mr. RETSINAS. Well, that's in the authorizing committees, of course.

Mr. PETERSON. I am just saying I think there is a problem in that we have not been able to get the authorizing and appropriation committees to really focus on this and understand what is happening. They just keep putting more money into this program because they don't know what else to do. That is what it seems like to me.

I will say this, that I have had some discussions with members of both committees, and they are starting to pay attention, for whatever reason.

Mr. RETSINAS. I appreciate your taking that interest.

Mr. PETERSON. I think we need all three committees to sit down and start figuring out what we are going to do about this problem so we don't keep wasting money.

Mr. RETSINAS. I agree absolutely. That is always better than to ruminate about the past, to point fingers, and to talk about what needs to be done. The more information we have about what options are available and what the cost of those options are, I think we would design more informed policies.

Mr. PETERSON. Mr. Zeliff, I know you are just chomping at the bit.

Mr. ZELIFF. Am I in the 5-minute rule?

Mr. PETERSON. No, we are here all day. So however long—

Mr. ZELIFF. Since we are both cosponsors and signed a petition to start the petition on A to Z, this is the kind of stuff that I think—

Mr. PETERSON. This is P to Z here today.

Mr. ZELIFF [continuing]. That is designed really to try to get at some of this. But you have got quite a challenge on your hands, and you have been there for 13 months. Some of this—a lot of—you inherited—\$11.9 billion, if I heard you right. And that is what is at risk of the \$45 billion total inventory, is that right?

Mr. RETSINAS. That is what I testified. That was the result of the audit a year ago when I first joined the administration. We had an audit a year later, and the number is \$10.3 billion, still much too much, by the way. Just to be technically correct, the current number at risk is \$10.3 billion; \$11.9 billion was the number when we first joined the administration.

Mr. ZELIFF. You say you made some progress. How would you describe what has been the key to your success?

Mr. RETSINAS. I don't think we have had much success at all.

Ms. GAFFNEY. We don't necessarily—

Ms. ENGLAND-JOSEPH. We wouldn't agree that it is a success.

Mr. ZELIFF. Maybe I can get all three of you to make a comment. You want to?

Mr. RETSINAS. First of all, the financial condition is often an indicator of physical condition. That is why financial statements are important. It is not just the money. The money alone would certainly guarantee our attention. However, I would agree that we have barely sort of touched the surface.

In many cases, we are putting into action the tools that we have talked about today. In other cases, we need more tools. This is a problem that has grown over time, and it has to be fixed over time. We need to have that understanding and that ongoing commitment and realization.

Ms. GAFFNEY. Well, with respect to the lost reserves, we have a situation where, as I said before, owners are putting in virtually no cash equity. The debt is nonrecourse. We can't get at them, and they simply can walk.

This is a situation that is so similar to the savings and loan situation where, because of deposit insurance, people were just able to take money and go. So——

Mr. ZELIFF. Thank you.

Ms. ENGLAND-JOSEPH. The \$11 billion down to \$10 billion in many ways are because of improved data collection and better analysis of data, not necessarily a true improvement in the problem. So I really want to make clear that there isn't a real correlation between that decrease and real substantial action on the part of HUD in improving that portfolio.

Mr. RETSINAS. I must admit, Congressman, even improved data collection is at least a modest step.

Ms. ENGLAND-JOSEPH. That is true.

Mr. ZELIFF. But what I got—I will be honest with you. And I haven't been here forever, and I don't want to be here forever.

Mr. RETSINAS. Neither do I.

Mr. ZELIFF. I will tell you in the limited time I have been here I have never heard so much of a horror story as what you are responsible for. How many people help you in this thing?

Mr. RETSINAS. In the whole department?

Mr. ZELIFF. Right.

Mr. RETSINAS. The department has about 13,000 employees. Less than half of those are affiliated with housing, though. Half of those are associated with our single family mortgage insurance program. As you know, last year we insured over 1 million loans with our FHA single family insurance program, which I might add turns a profit for the government.

Mr. ZELIFF. So what you are asking for—and I guess your problems are the staffing, lack of expertise, lack of management controls, data systems——

Mr. RETSINAS. And lack of money. Other than that, I think we have the resources we need.

Mr. ZELIFF. Is there a problem with the people that are working there?

Mr. RETSINAS. Just what I said, Congressman. I think we have good, honest, hard-working Federal Government employees. The difficulty is that we haven't had an infusion of new blood over time. There have been freezes on new government hiring for all the reasons that we all understand. We have not been able to bring on board people who have entrepreneurial business expertise which is why I have turned, for example, to State and local housing finance agencies.

Mr. ZELIFF. I appreciate your comment. I am familiar with the New Hampshire Housing Authority——

Mr. RETSINAS. Outstanding.

Mr. ZELIFF [continuing]. And some of the things that they are doing.

And I guess my—if I had to ask you, then, in a short sentence or two, how would you describe your mission now that you have been there for 13 months?

Mr. RETSINAS. Our mission is twofold: First, is to correct the problems that have occurred over time: fix the problem; and, second, to make a positive contribution to the desperate need that con-

tinues to exist in this country for affordable housing. These are our two primary missions.

Mr. ZELIFF. Do you have—have you come up with numbers on that need?

Mr. RETSINAS. The need is substantial. It is certainly measured different ways. It is measured in terms of people's inability to afford decent housing. In other cases it is a measure of living conditions. I refer you to a study completed by the Joint Center for Housing Studies at Harvard University, which talked about a gap of about 10 million units.

Mr. ZELIFF. Ten million units?

Mr. RETSINAS. I would refer you to that study. I would be happy to share a copy with you, Congressman.

Mr. ZELIFF. Just trying to do the arithmetic, of the moneys that you have now, I guess what I am trying to get to in terms of looking at the mission statement, you can accomplish your goal in terms of meeting the needs of housing, but not necessarily have HUD do the physical management.

Mr. RETSINAS. Absolutely. I think the words I used was "make a contribution," not "do." I think we have learned that if the Federal Government does it all, it doesn't necessarily get done well. We need partnerships.

Mr. ZELIFF. So do your mission statements incorporate you getting out of the management?

Mr. RETSINAS. Our mission statement incorporates a specific reference to partnering. What we need is partners, but we need also to be a better partner. We are often too cumbersome to be a good partner. One of the reasons we are conducting these forums around the country is to listen. We wanted to make sure the forums are not conducted in Washington, DC, but in communities all around the country. We need to begin to listen how we can be a better partner. The partners also have to be locally based. It is the New Hampshire Housing Finance Agency or the Minnesota Housing Finance Agency which I believe has a better understanding of local conditions.

We can bring some value to the table, but we need to have them engaged. I am so pleased that so many took advantage of our offer and have now entered into these agreements with us. I wish all the States would.

Mr. PETERSON. How many have?

Mr. RETSINAS. Twenty-seven States and six localities, including those two, and, also, New York.

Mr. ZELIFF. One of the things that troubled me a little bit was your comment that the majority of assisted housing is physically and financially sound.

Mr. RETSINAS. Sorry, but it is sound.

Mr. ZELIFF. What did you mean, physically and financially sound?

Mr. RETSINAS. Just that, it is the kind of housing that if you looked at it in the community, you would not identify it as assisted housing. It would look like a conventional housing property stock doing the job it was intended to do. That is the majority, but the majority, I am not going to hide behind statistics. That is still not good enough.

Mr. ZELIFF. The HUD Reform Act of 1989, how would you—what would you say has been done? What have we learned from that and what has been done in terms of improving management since 1989 with that act?

Mr. RETSINAS. Well, I can't speak to 1989, of course. I can only speak to what I have learned, what I have read, what I have talked about.

Mr. ZELIFF. I would assume things were worse then than they are now?

Mr. RETSINAS. Well, I try not to make assumptions, but clearly there were some programs that had fatal flaws in their design, the most notable being the coinsurance program, a program in which the Department engaged into partnership with private parties to undertake different housing developments. The difficulty was that all the incentives were at the front end, and that many of the participants, but not all, but many of the participants took those incentives and ran.

The risk-sharing agreement I have talked about has two fundamental differences. One, the State of New Hampshire is not going to disappear. They are not going to run away. They will be our partner over time. No. 2, these are shared risks, from \$1 all the way through, so what we have done is—and it was done in the previous administration, not just our administration, is try to shut down programs that didn't work and trying to put into place programs that do work.

Mr. ZELIFF. Now, in programs that do work, I would assume, are you talking about vouchers, are you talking about—I mean, in terms of New Hampshire, for example, what are they doing different that is going to make—I got your stuff last night, or I guess we got it this morning, and I didn't get a chance to read through everything this morning, so if you could describe maybe what is it ultimately—

Mr. RETSINAS. New Hampshire?

Mr. ZELIFF. Right.

Mr. RETSINAS. Sure, I would be happy to. I am proud of it. I do think so highly of the program. This is an initiative that allows the Department to enter into risk-sharing agreements with qualified entities such as State and local housing agencies. In this particular case I have signed an agreement with the New Hampshire Housing Finance Agency.

In the agreement they take the responsibility for originating or underwriting a mortgage insurance application. They look at a local project. I believe, Congressman, it is Mariners Village.

Mr. ZELIFF. I am familiar with the project.

Mr. RETSINAS. In Portsmouth?

Mr. ZELIFF. In Portsmouth, right.

Mr. RETSINAS. In this particular case I believe that they have a greater understanding of the local context. They have a greater understanding of the marketplace. In return for that, we are prepared to share a risk. They do the origination, they do the review, they do the oversight, and we share the risk. I think that is an appropriate role for the Federal Government to rely on local partners to take that kind of affirmative action. I believe that is the future, but I will know more when I come back from my forums.

Mr. FRICKE. Congressman, if I could just add, that particular demonstration program is one which GAO wholeheartedly supports. It is a program to help really get capital into the marketplace. It is a supply side type of program. But on the other side, I think it is worth referring to another study—Nic referred to the Joint Center for Housing Studies at Harvard—the department, themselves, puts out every year for the Congress to study called the worst case housing needs.

Essentially what this study has shown year upon year is that the problem, the principal housing problem the country faces is one of affordability, not availability. It goes in and points out that in most housing markets today there is a vacancy rate at or below the fair market rent of 6 percent or greater, saying, again, that vouchers and certificates in most markets will work.

Now, recognizing that a market, a city is a rather large geographic area and you have to take it down to neighborhoods so there are certainly neighborhoods where vouchers and certificates may not work, and, in fact, in some of the properties that we looked at, I think it is fair to say that vouchers and certificates would not work in all those cases.

Conversely, there were clearly communities where we went that vouchers and certificates, in our judgment, would work and would be a more cost effective approach, so, again, I will go back to what Nic had commented on earlier, when the Department sought greater flexibility and as the legislation wound down, I guess, and that flexibility that at least Nic sought may not have been forthcoming, I think it is an issue worth revisiting.

Mr. ZELIFF. In terms of, let me just ask you, I think you mentioned Cincinnati or someone did, 95 percent of the units inspected failed. I am just curious, when was that?

Mr. GREER. That was an audit report we issued in 1990. The work was done in 1989, I believe.

Mr. ZELIFF. What would it come out right now if we revisited that?

Mr. GREER. I would hope it would be a lot better, but there is really no way to say.

Mr. RETSINAS. What it is in Cincinnati today, no, I don't know.

Mr. ZELIFF. Well, I mean in the last 2 years. Has there been an improvement?

Mr. RETSINAS. I would have to look at Cincinnati. We have 81 field offices. I would have to check, Congressman.

Mr. ZELIFF. You mentioned legislation working its way through. Is that—

Mr. RETSINAS. I hope it's working its way through. At least under consideration.

Mr. ZELIFF. In committees in banking?

Mr. RETSINAS. Yes, the authorizing committees, in the House and in the Senate. Mr. Fricke said, we tried this last year. We asked for more discretion and the discretion got less. I will be as candid as I possibly can be. I am concerned about what will happen to the legislation this year.

Mr. ZELIFF. Do you have—I assume we have lease arrangements with people who are providers and there is probably a lease arrangement—

Mr. RETSINAS. Contracts.

Mr. ZELIFF. Contracts. Whose responsibility is it to oversee that certain things get done within that contract?

Mr. RETSINAS. Part of the responsibility relates to the department. Part of the responsibility relates to what are called contract administrators. For example, in some States we have contracted with the housing finance agency to be our contract administrator.

Mr. ZELIFF. But somebody is responsible for seeing that the contract gets—in terms of the GAO and the IG's office, you see generally that the contracts are fulfilled?

Ms. GAFFNEY. No.

Mr. GREER. No, sir, the Cincinnati audit was an audit of HUD as a contract administrator. Although that audit is somewhat dated now, I am not sure it would be a whole lot different. I think Nic and Helen might agree with us that conditions haven't improved a whole lot in the contract administration business.

Mr. ZELIFF. It seems to me that all the partners in this thing somehow have to agree to something and there has to be some accountability to see that it gets done. I just see this big money machine pumping out dollars, and what I worry about, and I sympathize because, you know, you inherited it, but I don't see—when did you do your strategy?

Mr. RETSINAS. We have been working on it from the first day I started. This was the first issue I addressed when I was sworn in on May 18, 1993.

Mr. ZELIFF. So the strategy we have here is something that has been out there?

Mr. RETSINAS. It has been evolving. The strategy will continue to evolve over time. This is a dynamic situation. What I tried to do is give you today an outline of the major components. All of it continues to be work that we are working on and will continue to expand with your support and interest over time.

Mr. ZELIFF. In terms of the IG's office, how would you describe your role in this thing and the things that you uncovered? If you uncover things that are not right—

Ms. GAFFNEY. Well, first of all, as Helen Dunlap indicated before, we have been working with housing in trying to design programs and regulations, and we are serving with them on an enforcement task force, but essentially I will be very straightforward and tell you to a very large extent we have given up on HUD.

Mr. ZELIFF. That, I think, is probably—thank you for being so honest and straightforward.

Ms. GAFFNEY. Well, you know, we have an enforcement mentality. We care about enforcement. That is what IGs are about, so you should understand that is our perspective. We believe for instance, that equity skimming is a major problem.

Working through HUD, we have in the past been able to get virtually nothing done in that area. We had maybe a handful of cases referred to the U.S. attorneys, and so in this past year we made a determination that we weren't going to go through HUD anymore. We were going to go directly to the U.S. attorneys, that we were going to make this a major focus of our work, that we weren't even going to bother issuing audit reports.

We are simply determined to go out and get data that will enable prosecutions because we believe, and that is our mentality, that unless someone gets the message that there is some enforcement and there is some expected accountability, why should anyone bother being accountable?

Mr. ZELIFF. So that I can understand the process, you make the report and you come up with some very alarming evidence. You report it to HUD and then they have a choice of doing anything with it or not?

Ms. GAFFNEY. Essentially that is what has happened in the past. We are not doing that anymore.

Mr. ZELIFF. They chose not to do anything about it, so then you go back into your offices and do whatever you want to do, but you don't necessarily have to do it again, so you have chosen not to do it again, so basically nobody is doing it?

Ms. GAFFNEY. Could you run through that again for me.

Mr. ZELIFF. It seems to me that we are going around in circles. You do an audit and you bring it to the people's attention. It gets ignored, you have now decided not to do any more audits, just working with the prosecuting for the U.S. attorney's office.

Ms. GAFFNEY. Essentially, if we found potential civil matters in an audit report, our practice had been to write it up in an audit report, give it to HUD to deal with through the Office of General Counsel and the Office of Housing, and then they would respond to it and decide what kind of action should be taken on it.

Mr. ZELIFF. If they choose to ignore it, then they do nothing.

Ms. GAFFNEY. Yes. Essentially what the IG's office has in the past has put it in their hands.

Mr. ZELIFF. And you have no other place to go at that point.

Ms. GAFFNEY. That is not our current posture. Our current posture is that we are taking unilateral responsibility for going to the U.S. attorneys. Now, we have made a commitment to the Office of Housing that we will advise them about what we are doing, and that when we pursue these prosecutions we will be pursuing properties that are both physically and financially troubled, where the tenants are suffering as well as the taxpayer.

Mr. ZELIFF. It worries me a little bit that—I think that that needs to be done, but it worries me that we are still not even going through the motions of doing the audit.

Ms. GAFFNEY. Oh, we are doing audits. We are just not issuing the report in the same way.

Mr. ZELIFF. Why wouldn't you be issuing the reports in the same way? Even if they are ignoring them, why wouldn't you still have the responsibility to do that?

Ms. GAFFNEY. Well, I am a little embarrassed to admit this, but what we have found is that the process of writing, reviewing, and issuing an audit report adds months to the effort, and the U.S. attorneys aren't particularly interested in audit reports. They are very interested in facts.

Mr. PETERSON. Could I just—this equity skimming issue, have you reported that to us? I don't recall you bringing this issue to us.

Ms. GAFFNEY. Yes. When we announced Operation Safe Home in February, we briefed your staff and we briefed other staff, too.

Mr. PETERSON. Maybe it didn't get through to me.

Ms. GAFFNEY. No, that is true, we did not brief you. The Operation Safe Home—

Mr. PETERSON. So you have information on this?

Ms. GAFFNEY. Yes, sure.

Mr. PETERSON. Would you make that available to me or get it to my office?

Ms. GAFFNEY. Absolutely. Could I just take 1 minute and tell you what was announced in February was our determined effort to take a kind of proactive stance against wrongdoing in HUD programs—

Mr. ZELIFF. Could I ask one more question?

Mr. PETERSON. Well, Mr. Retsinas has to go and—we are not going to cut off questions, but Mr. Retsinas has to go so the problem is the rest of them will be here, he won't be.

Mr. ZELIFF. Could I ask an important question.

Mr. PETERSON. OK.

Mr. ZELIFF. Again, I apologize, you have to go. I am sorry that we are being cut short here, but I sympathize with the job that you have ahead of you, and to the degree that we can help, I think we all want to help, but we sure don't like what we have heard, and I think you are dealing with a complete disaster in my judgment and, hopefully, we are going to be able to put our finger in the dike or do something, but I haven't had a chance to read your whole position paper, which, again, we got this morning, and assuming that it is very impressive and it does all the right things and that the GAO can go home and relax and that the IG's office and all of us can do that, is there a time line on that and is there a step-by-step chart which tells us what you are going to do and when you are going to do it so you have some really tight accountability and if not could we get that?

Mr. RETSINAS. On the one hand, yes. On the other hand, no. On the one hand, we have very specific management plan goals, for example, to work out troubled properties, so we can give you numbers and specifics.

On the other hand, Congressman, it depends on the resources and tools you give us. For example, I suggested that we are organizing SWAT teams that deal with troubled projects. We estimate that we can deal with somewhere between 30 to 40 projects with current resources. If you could expand the resources, expand the tools, we could do much more. Therefore, those time lines are very much dependent on the resources allocated.

Mr. ZELIFF. Given present resources, you have a time line in there?

Mr. RETSINAS. Yes, we have a specific time line for workouts, and can give you specific targets for these SWAT teams.

Mr. ZELIFF. Specific times that you want to be held accountable to?

Mr. RETSINAS. Yes. However, let me not kid you, that is not going to solve the problem. The resources aren't there to do that.

Mr. ZELIFF. On the record I would like to have copies, if you are going to have some meetings in your office on this, we would love to be a participant. Thank you.

Mr. PETERSON. I would like to know what these SWAT teams are going to do. Could you make that available to me?

Mr. RETSINAS. Absolutely, Congressman. They essentially focus on individual projects, but I would be happy to expand on that.

Mr. PETERSON. Could you put it in writing?

Mr. RETSINAS. Of course, sir.

Mr. PETERSON. You have to leave. I don't know, Mr. Flake, do you have questions?

Mr. RETSINAS. Mr. Chairman, I appreciate the courtesy. I would be happy to come back, but I have to conduct that forum to help restructure the new FHA in Detroit.

Mr. FLAKE. I realize you have to leave, Mr. Retsinas. Let me start by thanking you for coming to the district to see some of the many projects we have going in the sixth district in New York.

Mr. RETSINAS. I enjoyed it.

Mr. FLAKE. I guess since you do have to go, I can submit questions for the record. One thing I would ask, though, if you would just take 1 minute, and that is having seen what we are doing there and we have probably 1,500 or so various units under construction, primarily units that are assisted in some way, have you found that in dealing with—given that the program basically deals with for-profit motives on the part of persons who have the opportunity to get tax shelters, and when that tax shelter reaches the point of its termination, of course you have more problems with these properties.

Having seen what we are doing in that area and probably in some other areas around the country, do you find that nonprofits might be one way to be able to get to the gut of some of the problems that you are having as it relates to creating affordable housing, No. 1; No. 2, creating opportunities for those persons who have Section 8 vouchers to be able to not just be renters for the rest of their life, but because of the way we have structured those programs, to create the means by which they can ultimately become homeowners, which ultimately takes HUD out of the business of trying to hold those properties in the first place.

Mr. RETSINAS. My visit to your district was a real eye opener. It was a reaffirmation of all the good work I knew you are doing, and now I could see it firsthand. I think there are also, some lessons that were reaffirmed in that visit. One lesson is that individual project must be viewed especially in its community context that projects don't exist in isolation. They exist in relationship to the community. The more the sponsor, the developer, and the owner are made aware of that relationship and create the necessary linkages, the better chance that project has of succeeding.

It is clear to me that working with experienced, competent, community-based organizations is a good way to proceed. In some communities those organizations do not have that capacity. In other cases, I know examples, and you will see some in the following panel, where for-profit developers have been able to forge those kinds of links. It is clear, however, that the involvement of residents, the involvement of the greater community is a vital part of the answer to dealing with these problems.

I also agree that we need to find incentives to ensure that assisted housing is more transitional; that is, does not over time become institutional, residents must have opportunities which allow for ownership or other kinds of cooperative housing. We think those

are directions we need to explore. Certainly you have given us some interesting models.

Mr. FLAKE. Do you have capability to work with those groupings to create necessary capacity? The weakness is technical abilities, an ability to draw on professional services and to build an organization that can actually become a producer of housing.

Mr. RETSINAS. We are very limited in that ability. We are currently facing a budget review that would further reduce what capabilities we do have. This means it is even more important for us to identify local partners.

In New York, as you know, we are working with the New York Housing Development Corp. and with the State insurance agency to help provide that. I wish we could manage those resources directly, but because of the reasons that the chairman said earlier, this is a difficult environment to ask for new resources.

Mr. FLAKE. However, if you were refocusing some of those resources to where you were making investments in capacity building and thus making investments ultimately in home ownership, I think we would reduce the amount of money necessary to continue the program as it currently exists, particularly if we are putting people in the New York market where you are paying \$700, \$800 a month with a voucher, paying that kind of rent, and the houses you saw us having built we are paying, those persons in those homes are paying about \$800 a month for a mortgage, so that it is the same dollars.

The difference is that they become homeowners, they have a rental unit that goes with the apartment, so not only do they own it, but they also have the rental unit for additional income, and it takes us right out, it takes us, meaning HUD, right out of that market.

It seems to me if we are going to work with short dollars, we refocus those dollars in ways that gives us opportunities for, you know my term is always investment. I think our whole orientation to social programming has not been one of investment, and that is the reason we have a program like this is that this give it, give it, give it because there is more where we got it from and we will keep going back and getting more, I think that is what is killing us, and if we can treat it as investment, I think we can create the same kind of communities that you see us doing there. I think we can do that anywhere in the country.

Mr. RETSINAS. I think we can. It certainly puts an appropriate burden and challenge on all of us, however, to first clean up the situation that we have. I agree further that if we would design new housing programs today, they would be very, very different from the programs we've inherited. They would be programs that are not dependent exclusively on the tax code. They would be housing programs, not finance programs. That would be the fundamental difference.

The reality is that we have to deal with what we have. I think the kinds of initiatives that you have shown in Queens are the kind of initiatives and redesign that we need to be thinking about. That is precisely why I am conducting these forums.

The first one begins this evening in Detroit and continues all day tomorrow. I want to listen: to listen to community-based organiza-

tions and communities talk about how we can be a better partner in a different kind of HUD with a different kind of housing program.

Mr. FLAKE. Thank you. I don't want to hold you much longer. Let me ask—

Mr. SHAYS. Would the gentleman yield?

Mr. FLAKE. Yes, I will yield, since he has to leave.

Mr. SHAYS. Is that all right with the chairman's permission, just 2 minutes. I know you need to get on your way. I would like to understand one element of this. When we did the HUD investigation for such a long period of time, we knew that there were problems in a lot of different areas. I understand that you are dealing with something that you inherited, but basically the administration has been in for 2 years, so there will be a point where that will change. I also realize you need resources.

One of the things that amazes me and maybe you could just tell me this, if we negotiate with a landlord and we are putting in such extraordinarily high resources, and I guess it is the local housing authority that is doing this negotiation, we don't own these facilities, and to me it seems like a wonderful excuse. If they are not doing the job and we are paying market rent, it seems to me like we get savings if we get out of there and negotiate with someone who is willing to provide the market service for the market rent, so I guess my point to you is that I think—

Mr. RETSINAS. I agree.

Mr. SHAYS. OK. What it says to me, though, is there are a phenomenal amount of resources that are there being wasted—so I guess my point to you is that if we don't have the inspectors to make sure the local housing authorities are doing their job, can we have such a gigantic penalty to them that if we discover it, the cost is so great that they will want to do their jobs before you show up?

Mr. RETSINAS. Well, I think the penalty we need, Congressman, I think your analysis is generally correct with two qualifications. One, in some cases there are long-term contractual commitments, so we need to make sure that those commitments are—

Mr. SHAYS. But if they don't live up to those commitments, it seems to me, we should just get out of there, like see you tomorrow, goodbye.

Mr. RETSINAS. Absolutely. The ultimate lever, the ultimate tool that I am seeking from the Congress is the ability to say no to renewing that contract.

Mr. SHAYS. Or breaking them. Forget renewing them if they haven't lived up to them, break them.

Mr. PETERSON. There is some places that you can't do that. You haven't heard all the horror stories.

Mr. SHAYS. I will listen to the horror stories later.

Mr. RETSINAS. May I make just one point, if I could, Congressman.

Mr. SHAYS. Sure.

Mr. RETSINAS. The difficulty is if we were to do that under current law, not that laws can't be changed, but I can only deal with current law. Under current law we lose that assistance. We lose not only the unit, but more importantly the assistance. We can't

take that and move it to a nicer project. We are not allowed to do that.

Mr. SHAYS. But that is because of what we have done?

Mr. RETSINAS. With all due respect, the Congress.

Mr. SHAYS. You make it clear to us that we need to change that, and that is part of the reason why we do these reports, why we do the investigation. I thank the gentleman for yielding. I thank the chairman, but could I just say to the chairman, it just seems to me that is the reason we are doing this investigation.

Mr. PETERSON. Mr. Retsinas, I think you can see that we need you to come back another time.

Mr. RETSINAS. I would like to.

Mr. PETERSON. Would you be willing to do that?

Mr. RETSINAS. I would like to, sir.

Mr. PETERSON. We will set up some kind of a process here where we can get together in the committee and have some discussions because there is more to this than has come out here today and I think we all need a little bit more education, more information, and then we will have another hearing and we appreciate you being with us today.

Mr. RETSINAS. Thank you for understanding my schedule. I appreciate it. Thank you for your concern.

Mr. FLAKE. Reclaiming my time, several questions. Ms. Gaffney and Ms. England-Joseph, I realize in both of your roles you are basically not a part of the production end of this, you actually do the analysis and evaluation, but in so doing it would seem to me that there must be opportunities for you to do some economic analysis, particularly GAO, in terms of what it means to continue to make the investment or not make the investment, to continue doing business the way we do it versus trying to determine new ways of doing business that allows for investments so that you create permanent housing opportunities.

Would that long term, in either of your opinions, represent for us the potential for, one, lower cost and, two, by creating greater housing opportunities for people to own ultimately get us out of the stream where we are either talking about how to do one-for-one replacement or we are talking about how to create more subsidized housing opportunities and other ways.

What is just your general, broad opinion in terms of how we could go about making investments as opposed to having a whole lot of people either having vouchers or having Section 8 certificates or whatever other means that we have created, and I would exclude from this, of course, 202 and some of the elderly programs, I consider that a different category, but I am talking about for the every-day persons who we are providing this large sum of money for and the basis of providing them temporary housing in that sense, is there a way that you see we can move that makes some sense for us long term?

Ms. ENGLAND-JOSEPH. Yes, I think that if we were to approach this issue in a more holistic fashion where we look at the individual or the community in which that individual lives, try to understand exactly what it is going to take in order to create economic self-sufficiency, because that is what you are talking about, the

ability for individuals to be able to be economically self-sufficient is critical.

I think that there are programs that are either intended as designed or have been on pieces of paper for a long time, are intended to try to achieve the right kind of either social services or assistance or create the right kind of catalyst within a community so that you link people to jobs, with training, and all of those sorts of things are, in fact, very critical to creating the right kind of community environment for economic self-sufficiency, but I would be quick to say that there are a large number of people out there that are very, very low income, and that population will need a lot more assistance and probably for the long term will need some sort of Federal subsidy in order to assist them in achieving or meeting their housing needs simply because of the level at which their income or negative income level is. We have to look at the population and understand which part of the population needs what type of assistance and services and then how do we best provide that multitude of services across the whole continuum.

It is not an easy solution, and obviously it doesn't rest just with HUD. I mean, it really rests with a number of departments in government and programs that really transcend not just government, but local and city activities because they all have to work together in order to achieve what I think you are talking about.

Mr. FLAKE. I think you made the point I was about to raise as a question for you, and that is in terms of seeing government as a whole as opposed to seeing it in these various parochialized components that all of us make fiefdoms of so that if you are dealing with HUD issues that have to do with welfare, those issues ought to go into whatever welfare reform and trying to define also how you create economic opportunities in the very communities where the people need the jobs the most, so it does take more than just what HUD does. It is obviously a combination of various functions within government, understanding that they could do much more together than they all can do individually as they currently do.

Ms. ENGLAND-JOSEPH. We have some work under way that you might be interested in where we are trying to look at the unit of evaluation or measure as the individual or the place, the community, trying to understand it from that context in terms of the Federal Government and how Federal programs are brought to bear in that community or for that individual. Often we simply look at it from a program perspective and try to determine about what that program needs to be changed. I think more and more we are realizing that we have got to look at it from the other perspective because we have much duplication in government, a lot of bureaucracy, a lot of paperwork in terms of the ways in which people apply for grants or personal assistance. There are probably a great deal of cost savings that we could achieve if we were to look at it simply from a cost efficiency perspective, a much more streamlined approach to helping individuals or communities would, in fact, benefit the communities more directly because they don't know how to utilize all the different programs that exist in government.

Mr. FLAKE. And a lot of the people in government, unfortunately, from my experience have been trained to say, no, and to not be creative, so that you don't get much in the long end because they have

been doing it that way so long and that way is not working and nobody is willing to talk about change, and when you come with change they are the first people to say you can't do it, and it is not written anywhere, but you just never did it that way before.

I think it is time for us to really rethink how we do the whole housing area because I think there is a lot of—even though you need more resources, there are a lot of resources that are either being underutilized, that are being utilized improperly or may be being utilized in such a way that they benefit certain groupings and those groupings are really not benefiting the overall needs that we have as it relates to trying to resolve this problem.

Ms. Gaffney.

Ms. GAFFNEY. We have not done the kind of analysis that you are talking about of alternatives. But, until this discussion today, I haven't heard people focusing on this incredibly expensive endeavor that we are embarked on and wedded to in perpetuity, and it consists of insurance that puts our government at enormous risk, supplemented by the Section 8 project payments, which involve rental assistance payments that are escalating every year, and, you know, tax credits can also be involved in these projects. What we have been talking about as a result of your hearing is maybe one of the useful things we could do is to try to project where this is going to put us in 20 years in this Government. Because I think if you put all of this together and saw the exposure we have and what we are "investing," but not investing in your terms and what we are getting for it, we would all find that this is really not a tenable situation.

Mr. FLAKE. Thank you very much. I don't know whether that takes us a long way, but I think you get the picture that I am trying to present.

Ms. ENGLAND-JOSEPH. Before you came we talked a little about some of the properties we visited during our review. One of those properties is in Chicago, IL. I know I keep trying to get back to this property because I think it is such an excellent example of what we are trying to talk about in our testimony.

We are talking about a property that already rents at much higher than the rents in the surrounding area. We are talking about a property that is in deplorable condition. I mean we saw a video that demonstrated the condition of this property, and this did not happen in the last 6 months or the last 1½ years. People told us it had been this way for 8 or 9 years. So we are talking about major problems.

While I am pleased to hear that HUD as a part of their four-pronged strategy is talking about focusing on that property in particular and putting \$1.2 million into that property, \$1 million in flexible subsidy and \$200,000 in crime reduction activity, I would guess—

Mr. SHAYS. Would the gentleman yield?

Mr. FLAKE. Yes, I will.

Mr. SHAYS. Why would HUD put money into that project? I don't understand why you would be so pleased about it.

Ms. ENGLAND-JOSEPH. I am trying to get from a pleased to a displeased.

Mr. SHAYS. Think of what you are saying. We are paying—you are telling us we are paying above the market price, and it needs to be fixed up and HUD is the one who is going to put the money in. I yield back.

Ms. ENGLAND-JOSEPH. Forgive me, sir, the only pleasure was to know that something might be happening to this property. That is the only pleasure, let me make that really clear.

Mr. PETERSON. I hope you can stay because in our next panel the owner of this property, I believe, is here, and he has a story to tell which is—there is more to this than meets the eye.

Mr. FLAKE. I think the \$1.2 million comes very late in the game.

Mr. PETERSON. And you know the tax law changes and a lot of other things, so it is not—I guess I just want to say that I don't think it is totally this person's fault that it is in this shape, but I think your point is right. This is crazy what we are doing, and this whole idea that we are going to—that is what I was trying to get through to the Secretary here that we ought to really think of whether we should be doing this at all and maybe it is time to bite the bullet.

It is like my farmers that we kept stringing out that basically are broke and nobody wanted to tell them they were broke, and they wasted another 5 years of their life before they finally were put out of their misery. Maybe what we need to do is just admit that this is a mistake, somehow or bite the bullet and get on to some other strategy as Mr. Flake is talking about. We are not exactly sure what it is, but this is an endless rat hole here if we don't.

Ms. ENGLAND-JOSEPH. The reason I brought that particular example up in the context of your earlier question was aside from the issue of how we should fix this property, if we should at all, we believe that any analysis project-by-project ought not to just look at how much money do you pour into the property in order to make it livable. I mean, we believe that you have to look at the surrounding community and do what HUD has said.

Think about concentrations of poor people. In the community we are talking about where this building exists, it is highly concentrated in terms of low income. It is below the average income of Chicago, and you have to look at the minority makeup of this community in terms of concentration, a concern that HUD has had. We have to look at whether there is other available housing in that area where we could provide a much more efficient subsidy process, meaning tenant-based Section 8 instead of linking the subsidy directly back to this project in order to maintain this project's cash-flow for some period of time. We are suggesting that when HUD makes a decision do it project-by-project and go beyond the dollars and cents of what is it going to take to just make it livable.

HUD has got to look at more cost efficient ways of operating, and it has got to look at the social issues that it is really trying to achieve, and possibly the bottom line is to do something quite different.

Mr. FLAKE. My last point. Speaking of Chicago, have you examined my MINCS program, which is being piloted in Chicago with Vince Lane and the Chicago Housing Authority?

Ms. ENGLAND-JOSEPH. I have not.

Mr. FLAKE. Mixed Income Neighborhood Program.

Ms. GAFFNEY. No.

Mr. FLAKE. What they are doing basically is trying to find new ways to use some of the public housing money which we authorized for them to do to be able to create some permanent housing. We changed the variables in terms of who can live in this housing by putting some folk who work, who have jobs in the midst of people who may be welfare bound, and it has gotten a great deal of publicity. You might want to take a look at it.

Vince Lane is the chairman there, and I think we did that legislation. What is it 3 years ago? About 3 years ago and they produced some units. I think it is something you might want to look at because I think it has possibilities. I yield, Mr. Chairman. I have to go to Whitewater hearings. I am sorry I have to leave.

Mr. PETERSON. We have another panel. Mr. Shays, do you have a couple of questions?

Mr. SHAYS. I think the next panel is very important, and since I missed your basic discussions, I don't feel that I should be getting into much. However, my assistant here has taken some notes and some of what he has taken I find distressing. Since I was here, Ms. Gaffney, for your comment, where you said, "I am embarrassed to admit," why were you embarrassed?

Ms. GAFFNEY. Oh, it is not major—it takes us a long time, us auditors, to write audit reports.

Mr. SHAYS. OK. So you are not embarrassed that you didn't do the reports? Are you going to be doing the reports?

Ms. GAFFNEY. No. I need to take a minute and see——

Mr. SHAYS. Are the reports in writing? Have they been completed?

Ms. GAFFNEY. We are not compiling regular, normal audit reports.

Mr. SHAYS. I just find that totally unacceptable.

Mr. PETERSON. Mr. Shays, if you would yield, the problem is if you ask them to do that, then this information isn't going to be available and we are never going to get anything done.

Mr. SHAYS. I find that unacceptable, too, because I don't buy it. I don't buy it. I mean if you don't file the report, it is not an official document, correct?

Ms. GAFFNEY. That is correct.

Mr. SHAYS. OK, and the coverup continues as far as I am concerned, so it is just word of mouth between people?

Mr. PETERSON. There is no coverup. We have sufficient information to——

Ms. GAFFNEY. Wait a minute. Can I clarify? Maybe I can start from the beginning.

Mr. SHAYS. I don't want you to start from the beginning. No, I don't want you to start from the beginning. I just want to know do you have reports that you are supposed to do?

Ms. GAFFNEY. We are issuing audit reports on every aspect of HUD's operations. They are——

Mr. SHAYS. Except where?

Ms. GAFFNEY. In two areas of Operation Safe Home, we have decided that we need to uncover wrongdoing, to target wrongdoing, and try to get prosecutions. Typically if you find wrongdoing in the

course of an audit, in fact, that audit is put on hold and you do an investigation.

In two areas, equity skimming and fraud in public housing administration, we are going in and we are doing probes. We are doing audits, along with investigators specifically targeted to finding fraud and equity skimming. We take the results of what we find, if there is any evidence of wrongdoing, to a U.S. attorney.

Mr. SHAYS. But you don't document it in a report?

Ms. GAFFNEY. We are not in those two cases issuing a formal report.

Mr. SHAYS. We will have to pursue this later. I do not understand why you would not document it in a report. It seems to me that the report is something that becomes public. A report is something that is used by Members on both sides of the aisle, and it helps us do our job, and I just—

Ms. GAFFNEY. Fine. Really, I would be happy to talk to you about it.

Mr. SHAYS. I just want to—at least I want to make it clear to you, I can't imagine our allowing the former Inspector General to say that to us under Tom Lantos and Tom Lantos saying, "oh, yeah, well, I understand." I don't understand it, and—

Mr. PETERSON. You need to be a CPA, Mr. Shays.

Mr. SHAYS. No, but see maybe that is the problem.

Mr. PETERSON. We are all messed up like everything else.

Mr. SHAYS. But you know what, I don't mean any disrespect to you because I think you are doing a terrific job and I didn't mean it to come across in any other way. I am just thinking what Tom Lantos would be saying to you now. It just seems to me that one of the things we encountered with previous Inspector Generals, was that they were telling us, and we, Congress, weren't listening. We weren't doing our job to the full extent, but one part was that they also weren't telling us things that we needed to know.

Those reports are essential to us to make good policy decisions, and you are doing half the job. It seems to me you aren't doing the complete job if you don't issue those reports. That is the way it seems to me. We, obviously, have a difference of agreement.

Ms. GAFFNEY. I would appreciate the opportunity to discuss it with you further.

Mr. SHAYS. Given that I have missed the testimony and since I don't want to be redundant and since it is late, I respect the concern of the chairman.

Mr. PETERSON. Well, as I said, we are not going to drop this issue after this hearing. We need some more information, and we are going to be looking into not only this current issue, but we are also going to be looking into the tenant-based Section 8. We are going to look at the low-income housing tax credit properties as well. There is a lot of work that needs to be done. We appreciate all of you being with us. Does anybody have anything else they want to say? You look like you had something to say?

Ms. GAFFNEY. No.

Mr. PETERSON. Thank you very much for your good work. We appreciate it, and we will continue to talk with you about these issues.

Mr. PETERSON. Next, we are going to call the final panel. We have some of the people here that have been kind enough to be with us today to share with us their perspective as people who have been involved in this situation. I think folks might be surprised to hear the other side of the story. I hope people will stay around to hear these witnesses.

If we could have the witnesses come up, we have Artie Jackson, who is a resident of the Holiday Lake Apartments in Pompano Beach, FL; we have Dr. George Graham, who is the owner of the 6000 South Indiana Apartments in Chicago, which have been discussed here in some detail today; John Orehek, the general partner of SP Properties 1982 Limited Partnership that owns Edgewood Terrace Apartments, located in Washington, DC, who is accompanied by Roy Lee, associate counsel with the Security Properties Inc., Seattle, WA; and Eugene Ford, president of Mid-City Financial Corp., owner of Edgewood Terrace Apartments II, in Washington, who is accompanied by Elliott Bernold, president of the Edgewood Management Corp.

The last two apartments named Edgewood are located next to each other and are in quite different contrasting condition as we said earlier. Have we got everybody lined up here, do we? We appreciate you all being with us today. We apologize for how long this has all taken, but when we did this, we didn't expect that we were going to be running against Whitewater and King Hussein or that we would get into so much discussion, but we do appreciate your being here.

As you noticed probably, those of you who have been with us, it is the custom of this committee, because we have investigative hearings, to swear in all witnesses so as not to prejudice any of them. Do any of you have any objection to being sworn in? If not, would you please rise and raise your right hand.

[Witnesses sworn.]

Mr. PETERSON. Thank you very much. We will start—your written statements will become part of the record. I, guess given the lateness of the day, if there is a way you can summarize, that would be helpful, and we will start with Mr. Jackson. We appreciate you being with us, and as I said, your statements will all be part of the record. If you could summarize them, that would be helpful.

STATEMENT OF ARTIE JACKSON, RESIDENT, HOLIDAY LAKE APARTMENTS, POMPANO BEACH, FL

Mr. JACKSON. Good afternoon, Mr. Chairman. It is an honor to be here, members of the committee. My name is Artie Jackson. I am married, I live with my wife and four children at Holiday Lake Apartments in Pompano Beach, FL. I work for the Pompano Merchandise Mart. I have lived at Holiday Lake since December 1986.

I am currently right now vice president of the tenant organization, Concerned Citizens of Holiday Lake Apartments. Holiday Lake Apartments has 232 units in 15 residential buildings. There are also two service buildings; 180 or more receive Section 8 project-based subsidies. The owners have also, have also applied for the remainder to be subsidized as well.

Behind the project is also a lake, a pretty large-sized lake. That is why it is known as Holiday Lake. In 1986 my first apartment was a two-bedroom on the first floor. It was totally vermin infested. There were roaches in the stove, the refrigerator. They were all in the cabinets. We used to have to continually scrub inside and out regularly just to keep the control of roach feces from building up. Marcrum Management were the owners at the time. We complained to them about the situation, but they basically said they couldn't do anything to control the problem.

We complained so much that finally instead of fixing the problem they just moved us to another apartment. That apartment was also—this was a three-bedroom, but the problem there was overrun with rats and mice, and as fast as I would try to plug up the holes in the apartment, they would chew through somewhere else. Our children were afraid, they were so afraid at that time to even sit in the living room. They wouldn't go in the kitchen because they were afraid of getting bitten.

We complained to the management again about the problem, but nothing was ever done. I don't understand why there was never anything done, but it just wasn't done. We had problems with the leaking in the kitchen and also in the stairwell. That was never done, nothing was ever done about that. There was conditions we had in the living room, our windows were so cheap they would fall out. The panes would actually shake from the wind whenever there was a slight wind blowing because they were not even sealed in properly, you know. There were problems with the electrical lighting in the kitchen and in the living room. You would actually hear, the lights would flicker on and off when you turned the switch on because of the faulty electrical panel in the kitchen.

When you would actually turn on the light switch in the kitchen you could hear the electricity pop, and once again we complained about these situations like holes in the bedrooms and whatnot. Nothing was ever done. The only thing they did was told us they were going to move us again. This time they promised us a newly renovated apartment which was supposed to be a three-bedroom apartment.

We moved into that apartment in May 1989. When we first moved there the minute we came in we turned on the air conditioner. There was a foul odor in the house. What happened was basically a dead bird got sealed up in the air conditioning duct somehow, I don't know how, but this was a new air conditioning unit and it had decomposed there and when we went and complained to management, they did absolutely nothing to get it out. You know, finally outside of complaining we had to go to court and the judge had to order them to remove and replace the duct work.

Since that time there has been numerous problems as well. There has been the bathroom toilet that to this date is not mounted, not even secured to the floor. Water leaks down into our kitchen. You have the cabinets in the kitchen are falling apart. They are falling away from the ceiling, and away from the wall, and the way they repaired it, they simply took caulk and just squeezed it between the spaces and left it that way.

There is an adjacent apartment that leaks down in our bathroom that hasn't been repaired. We just have so many different numer-

ous things, I don't want to belabor the point, but what I want to say is this. You know, my experience and the experience with my neighbors is that if there is any kind of repair that is going to cost any kind of significant amount of money, it is not going to be done. It is just going to be totally neglected, and that seems to be the policy, you know, since even prior to when we moved there.

I can't imagine how HUD could allow this to continually go on. For instance, the sprinkler systems, they failed years ago, I mean years ago, and to this day they have never been repaired or fixed. As far as the complex on the outside, you have grass and weeds, and—I mean you don't have grass, you have weeds and dirt. This is the landscaping. You know, the children have to play around trash and broken glass, you know, condoms and stuff laying around where they walk barefooted. These kind of conditions exist at Holiday Lake Apartments.

You have stripped, abandoned cars in many of the parking lots that have never been towed, even though there is constant complaints to the management. Nothing is ever done about the situation. Last June 1993—no, prior to that, before the inspection there was only like about seven or eight vacancies, I mean six or seven. Now there are about 33, and half of those are being used right now for prostitution, for drug dealing. In fact, even as we speak now they are still open to this day, nothing has been done.

That is why I couldn't understand Mr. Retsinas's comment about everything is taken care of. It is not taken care of. In fact, you know, these apartments are left open and then they are vandalized, but in addition to that, you have current management that has been going to these apartments and cannibalizing, taking off the parts to repair other apartments, taking out hot water tanks, doors, anything that they can salvage.

We had two laundry rooms at one point. Each had eight washers and eight dryers. One is shut down so now you have like eight washers for the whole complex. This is current. There are large gaps still in the fence to this day. A child has already drowned at the complex at one time. I have reported on one occasion actually the case of vandals, when the fence was actually cut. Nothing was ever done about that situation as well.

Now, there was an inspection done back in June 1993. They called it 100 percent housing quality standards inspection. They failed that. They also failed a similar inspection in November. I keep hearing this talk about how, from Jim Chaplin and Mr. Retsinas, about everything being better, but it is not. It is worse, and the problems are constantly building. And pumping moneys in is not really changing anything. The plumbing is so corroded and just deteriorated, it defeats the purpose of going in and actually trying to paint over and renew the apartment when, for instance, in a couple of the newly renovated apartments there are brown stains where you can see the water is actually leaking into the apartments. You know, it is not solving the problem.

Another thing I have a problem with is the fact that they want more moneys to take care of this. There has been plenty enough moneys spent already to alleviate these problems, but it has been wasted. It has been totally wasted, and there has been a lack of

concern by management and by HUD officials to do anything about the problem, and to me, I feel that this is abandonment.

The people in Broward County have been abandoned by HUD officials, the owners, and management. I feel that it is a disgrace and that something needs to be done now. We would like for HUD to foreclose against the owners because of the reputation that they have built in the community. They have shown over and over again that they cannot and that they will not do what they are supposed to do.

The last thing I want to say, I am concerned more so about our youth and our young people that are growing up there. To me, this is a form of abuse, and it has been an ongoing form of abuse. You got HUD officials that won't do anything, you got landlords that won't do anything, and it creates an atmosphere of hopelessness and despair, and that is what is at Holiday Lake now is a hopelessness and despair. I am just hoping that something gets done immediately. We need help out there. We need help, serious help.

[The prepared statement of Mr. Jackson follows:]

July 26, 1994

STATEMENT OF ARTIE JACKSON

TO THE SUBCOMMITTEE ON

EMPLOYMENT, HOUSING AND AVIATION

I am Artie Jackson. I am married and live with my wife and four children at Holiday Lake Apartments in Pompano Beach, Florida. I work for the Pompano Merchandise Mart in Pompano Beach.

I have lived at Holiday Lake since December, 1986, and am vice-president of the tenants' organization, Concerned Citizens of Holiday Lake Apartments. Holiday Lake Apartments has 232 units in 18 residential buildings, with 2 service buildings. 180-odd apartments receive Section 8, project-based subsidies. The owners have applied to convert the remainder to Section 8 also. Behind the property is a good-sized lake. In 1986, my first apartment was a 2-bedroom on the first floor. The apartment was vermin infested. Roaches were in the stove, refrigerator, and all the kitchen cabinets. We had to scrub the cabinets inside and out regularly to try to control the buildup of roach feces. Marcrum Management, the operating agent, claimed they couldn't do anything about the problem.

In response to my frequent complaints about that apartment, management finally just moved us to another unit rather than fix the problems. Our second apartment was overrun by rats and mice. As fast as I'd seal up holes in the walls, the rats would chew through somewhere else. Our children were so afraid of being bitten they refused to go into the kitchen or sit on the living room floor to watch television. We also had water leaking

into both the kitchen and stairs. Both ceilings were eventually badly damaged because management never bothered to respond to our complaints to fix the leaks. The excuses for not taking care of these problems were never-ending. Our living room windows would sometimes fall completely out they were so cheap and in such poor condition. The window panes rattled in the frames in the slightest wind because they weren't puttied in. The living room and kitchen lights flickered off and on because of a faulty electrical panel. You could even hear the sound of electricity popping when the light switches were flicked on. There were holes in the bedroom walls. Rather than fix these problems, management told us to move again. We were promised a newly-renovated three-bedroom apartment.

In May 1989, we moved into that apartment, our current apartment, a three-bedroom duplex. What we found in this supposedly newly-renovated unit was a pervasive, foul stench. There was a decomposing dead bird which had been sealed up into an air duct. We complained again to management and, true to form, they did nothing to rectify the problem. Finally, I took them to Court and a judge ordered management to remove and replace the duct work. The apartment also had other problems. The kitchen cabinets were pulling away from the ceilings and walls. Management repaired this problem by simply caulking the gaping spaces. The upstairs toilet is not mounted securely, causing it to leak into the downstairs ceiling. This problem has never been fixed to this day. A leak from an adjacent apartment also drips into our downstairs bathroom. When the air conditioner upstairs required servicing, the maintenance people dumped in so much acid that the drip pan disintegrated, causing additional leaks into the living room

downstairs. When I complained about this problem, the on-site manager told me I was the problem, not the apartment.

I finally began a rent withholding action in early January 1993. When nothing was done to take care of the problems by late January 1993, I went to Legal Aid Service for help. Some satisfactory repairs have been made to my apartments over the years, but they have been made by me alone and at my own expense.

My experience and that of my neighbors is that if a repair costs any significant money, the repair isn't made. For instance, the sprinkler system failed years ago. It's never been fixed or replaced. The landscaping now consists of dirt and weeds. Anytime management does attempt repairs, the work is so shabby and haphazard that the damage is eventually compounded.

The outside common areas of the complex are in deplorable condition. Rats abound, dumpsters overflow, trash, condoms, broken glass, and human feces litter areas where little kids play in their bare feet. The meter rooms are trash filled and unlocked so that electrical panels with dangerous high-voltage lines are within easy reach of little children. Stripped, abandoned cars sit rusting in many of the seven parking lots at the complex.

Last June 1993, there were approximately six or seven vacant units. Now there are thirty-three. About half are open and are havens for drug users and prostitutes. Vandals have caused significant damage in many of these empty units. Management has further damaged these units by cannibalizing fixtures and appliances for replacement parts. One of the two laundry rooms is locked and non-functioning, leaving eight washers for 200 families. There are large gaps in the fencing between the complex and the

lake. One child has already drowned in the lake.

The tenants have lodged many, many complaints with Pompano Beach Code Enforcement. They respond and cite the owners. When fines finally kick in, management makes a hasty, bandaid repair -- just enough to stop the fine from accumulating. The individual and corporate owners in Dallas, Texas are served with and sign for Code Enforcement's notices of these violations. Each notice asks that they call immediately to discuss the situation. The current Code inspector tells me that not once have the owners bothered to call. The owners currently owe the City of Pompano almost \$45,000 in unpaid fines. Code Enforcement currently has prosecutions pending on eight units, and investigations are being made on twelve other units. The Unsafe Structures inspector is investigating complaints about the unsecured empty units. The Pompano Beach Building Department was at the project on Monday, July 18, investigating the structural integrity of the buildings.

This complex failed the 100% Housing Quality Standards inspection done in June 1993. It also failed overall the 100% Housing Quality Standards inspection done in November 1993. Notwithstanding what HUD, the owners, and the management say, things have gotten worse, not better at Holiday Lake since November, 1993. Virtually every apartment now needs completely new windows. The plumbing is badly corroded and in terrible condition. Newly painted units have brown stains forming on the walls and ceilings from leaking pipes.

And now, we understand the owners want government money to pay for cleaning up their own mess in the form of a subsidized loan. Ladies and gentlemen, the owners don't live at Holiday Lake.

They don't even live in Pompano Beach -- they live in million-dollar-plus homes in Dallas, Texas and Pacific Palisades, California. The HUD officials who have apparently abdicated their responsibilities don't live there either. But it is the citizens of Broward County who have to put up with this disgrace in their midst every day, not the owners, and not HUD. And we are sick of promises from the owners and management companies, and sick of the smiling officials from HUD telling us how much better things are at Holiday Lake. I live there and I'm telling you they are not. We need help, we needed it long ago, and we need it now more than ever.

Lastly, it is our children who suffer the most. If you want to call it like it is, our kids are suffering from abuse by their own federal government and these out-of-state landlords. Our children are ashamed to get off their school buses. They're ashamed to tell people where they live. They have no place to play but in front of dope peddlers, drug abusers, and prostitutes. It's a downright shame, and very, very wrong.

Thank you.

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Mr. SHAYS. Amen.

Mr. PETERSON. We are going to try to help you, so we appreciate very much you being with us today, and your testimony. You have been there since 1986?

Mr. JACKSON. It was falling apart even prior to that.

Mr. PETERSON. Thank you. We are going to have some questions for you.

Next we have Dr. Graham who is from Chicago, and doctor, we appreciate you being with us today, and we will give you a chance to tell your side of the story.

**STATEMENT OF GEORGE C. GRAHAM, M.D., OWNER, 6000
SOUTH INDIANA APARTMENTS, CHICAGO, IL**

Dr. GRAHAM. I first want to say that wasn't my project.

Mr. PETERSON. No, I understand.

Mr. SHAYS. Is yours better?

Dr. GRAHAM. Well, actually from what I have heard today I guess I don't fit into many of these categories as an owner. They are saying that owners were taking money out of the project. They were saying projects had excessive rents, and my project does not fit any of those.

Actually, I have had this project for about 23 years in the black community in Chicago. Right now I manage one of the only ones that have the same management in that city. They have all basically changed hands. I worked very hard with this project. Basically, my problem has been underfunded.

Now, one of the panelists earlier said that this project was getting more rent. As of March, my one-bedroom apartments were \$450 a month. My two-bedroom apartments were \$500 a month. My three-bedroom apartments were \$550. It is not about to be overfunded, no way. In fact, the going rent in Chicago almost was double what mine was.

Now, I think my problem is this, and I think I made a mistake here. It has been a personality problem. For some reason I go down and I had a very extreme time getting rent increases. I have some exhibits here I have mailed out that shows one of the reasons, what they would do basically was come out, look at the property, and say something to the effect that there is some violations here and then that is a reason for not getting the rent increased.

Well, how can I fix the property if I don't get a rent increase? If you look at the history of this building, if you look at the financial statements of the building, you will see this building has been grossly underfunded, and they have known that. I have gone in and talked to them on numerous occasions, and this has been the situation.

Now, she also mentioned one thing about the fact that this problem, this was taken back by the government. I will tell you what happened. This is on the paper that I sent to you. Actually, after 20 years, you know, they say you can sell the property. All of a sudden a lot of activity developed around that time that this property could be sold. All of a sudden there was a tenant organization that was formed by about 10 people in the building of about 70.

No. 2, they hired a legal assistance foundation to help them. I started getting all sorts of calls from different buyers who wanted

to buy the building. They started meeting with people in the building saying, they started meeting with developers, and then they started passing out literature that I sent you a copy of saying we can own the building, so there was an incentive for them to tear it up as much as they could and somehow they could get inspectors out. They could get the papers out. They could get them to come in and see things that had just occurred. But my impression, and I will say it is my impression, that they were trying to take my building over. They were trying to get the building, that is basically what had occurred.

I was mentioning the fact that they said that the building had been backed into—it hadn't been foreclosed but it went into default. Now, what had happened is this: My taxes were normally \$30,000. The local tax authority sent me out a bill for \$110,000 that the Weyerhaeuser Mortgage Co. in California, who was the mortgager, paid the \$110,000 which automatically threw my bill into default. That is what I think.

At that time, I will admit I was about 2 months behind, but that is why that building was—and we had a meeting there, and it was the local HUD officials in Chicago concerning this, so I just—and I look at it this way: Considering the fact that my rents were so low, I was losing almost \$800,000, I guess—no, about \$400,000 or \$300,000 a year worth of rent on that property, and so this is my problem. I did not get enough funding for the building. Now, I have a manager taking it over now and all of a sudden everything is working fine, the same building.

Now, another thing they mentioned is the fact that they had given money to the project. Well, all they did was brought the rents up to what they should be. It went from, the rents that I quoted you earlier, which were roughly a little more than half of what the normal rents are to what they should be now. Now they are saying that money that I have I should use that for 3 years to help rehabilitate the building, and these rents are just the going rents for a building that size. It is average. It is not an extra amount of money, and so this has been my problem all along, and I will just look to make sure I am not missing anything.

I am trying to give you a synopsis without reading to try to save some time. Right now I am in court because the Legal Aid Foundation—oh, I sent you also a list of tenants who were not a part of this, that showed you they knew what I was trying to do to the building. This list testifies to the fact that the tenants knew what I was trying to do. It was only—and really of that 10 who formed the tenant organization, they could only get 5 to initiate this suit, which tells you something about the fact that the tenants knew basically what was going on.

I had taken the tenants, many of them, down to HUD. We had meetings with some of the local officials, and was trying to get things turned around, but I just want to bring out the fact that the reason why this building is in the situation it is strictly funding, definitely funding. It was grossly underfunded, and it was no way in the world that I could run this building that way.

[The prepared statement of Dr. Graham follows:]

GEORGE C. GRAHAM, M. D.
 8044 SO. COTTAGE GROVE
 P. O. BOX 18328
 CHICAGO, ILLINOIS 60618
 TELEPHONE (312) 848-0604
 FAX (312) 848-0604

July 22, 1994

Congress Of The United States
 House Of Representatives
 Committee On Government Operations
 2157 Rayburn House Office Building
 Washington, DC 20515-6143

RE: 6000 S. Indiana Apartment
 6000 S. Indiana
 Chicago, IL 60619

Dear Sirs:

I am responding to the letter that you sent me concerning, 6000 S. Indiana building providing you with a brief outline of the history of the project.

The building was built in 1971, for \$1,390,000. Originally there were no section 8. This was a 221-D3 project. The rent from the out set was not enough to cover security.

I used five different management firms over a six to seven years period, but each time loss ten to fifteen thousands of dollars per years, where incurred, so I develop an in house office on site management.

About six years after I have the project, I had to give \$35,000, in order to avert foreclosed. Each time I applied for rent increase, I only recieved barely enough to keep the building running. I have brought year end reports for every year I have had the building with me in case anyone would like to view them.

In order to keep the building expense down, I did not take any management fee for the first twelve to fourteen years. I also contributed my own money toward the project, periodically.

It was about six to seven years after the building was built, that I receiving section 8 subsidies, which covered approximately 70% (seventy percent) of the apartments. The remainder of the apartment had to be rented out, to Chicago housing tenants. The Chicago Housing tenants section 8 subsidies, which remained with the tenants wherever they went.

About seven years ago all of the apartment received government section 8. My problems was not getting rent rates that were high enough to meet the financial needs of the building.

In the month of March, of this year, I received my first increase in five years. The rent before that time was \$450.00, for one bedroom apartments, \$500.00 per month for two bedroom apartments and \$550.00 per month for three bedroom apartments.

GEORGE C. GRAHAM, M. D.
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July 22, 1994

These rents were about 1/2 of the prevailing rents at that time. This deficiency in funding prevented my proper up-keep of the building, which was excessive due to the large number of children in the building. During the time I have the building, I have to go to court numerous times for building violations. Vandalism was high from both tenant in the building and outside coming into the building, due to lack of security officers.

According to the original contact, The building could be sold after twenty years. In 1991 this project was twenty years old. A few occurrences developed around this time that bears mentioning.

First, about 1 1/2 years prior to that, I was sent an erroneous tax bill for \$110,000, which should have been \$30,000. The bills were going to Weyerhaeuser Mortgage Company in California. They notified me of this sometime later. I went to the tax authorities and informed them of the error and began the process of correcting it. The authorities readily admitted that the bill was an error and indicated that they would correct it, but before the process was completed, Weyerhaeuser Mortgage paid the \$110,000, which automatically threw the building into default. I subsequently had to file a certificate of error which would take two years to for me to receive the excess money I had paid.

Another interesting development was that of a tenant organization in the building that was formed. This had never occurred before. It was comprised of about ten tenants. There are about seventy apartments in the building. The Legal Aid Foundation subsequently began meeting with developers. They also began passing out handbills to the other tenants stating that "we can own the building". It was impression that developers were taking advantage of the fact that the building could be sold and the Jack Kemp Hope Program, and were using the tenants as a decoy. I also began receiving letters from the local HUD office about it possible foreclosure if the physical and financial conditions of the building were not brought up to standard. I began getting letter from potential buyers also.

I retained a lawyer and notified my congressman who sent representatives to a meeting with HUD. The return of the excess tax money brought the mortgage notes to three months behind. I turned the building over to Eastlake Management.

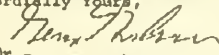
GEORGE C. GRAHAM, M. D.
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The Legal Foundation was used to file a law suit for five of the tenants of the tenant organization. They, the tenants state that they suffered mental and physical harm due to the conditions in the building. This case is scheduled to go to trial the first week in September. I asked HUD officials for the the back management fees that I did not receive and for the loans I made to the building and they "said no", I have been told that the legal fees of the trial could increase to the extent that, should I lose the case, I could wind up losing the building by being forced to sell it.

I feel very unhappy about the fact that after all of my time and efforts and money I put into the project that I am about to lose it. I feel that the problems associated with this project were directly related to the fact that I did not receive enough rent to properly maintain the building. For the most part, my rents were below those HUD properties in my area.

I had barely enough money to make repairs that were excessive due to the tenants and the large number of children in the building. I feel that HUD could have brought this to a head long before now before all of the problems developed. I have had and maintained this building in a black neighborhood in Chicago for twenty three years. Only a very few of the project in the black neighborhood survived this long with changing owners.

Cordially Yours,


 Dr George Graham



U.S. Department of Housing and Urban Development
Chicago Office, Region V
547 West Jackson Boulevard
Chicago, Illinois 60606-5780

MAR 21 1989

Dr. George C. Graham
8044 South Cottage Grove Avenue
Chicago, Illinois 60617

Dear Dr. Graham:

Subject: Project No. 071-55119
6000 South Indiana Avenue
Chicago, Illinois

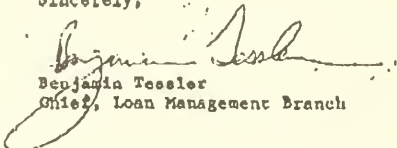
Consideration has been given to your request to increase the rentals in the captioned project.

This letter is to advise you that the requested rent increase has been denied based upon the HUD engineer's On-site Inspection Report dated February 23, 1989 which states in part:

"Most of the items noted in previous inspection reports dated 1/11/84 and 11/29/88 show no corrective action being made. Paragraph 8 of the Regulatory Agreement states that owners shall maintain the mortgaged premises, accommodations, grounds, equipment and appurtenances in good repair and condition."

Contact Edward Hook at 886-2579 should you have any questions.

Sincerely,


Benjamin Tessler
Chief, Loan Management Branch

Dr. George C. Graham M.D.
July 22, 1992

May 7, 1992

Former city worker, 7 others accused of bilking voter group

A former city worker and seven other people have been indicted on charges of bilking a non-profit organization out of more than \$42,000 by falsely claiming they had registered thousands of new voters.

The Chicago Voter Registration Coalition paid the eight \$1 for every new voter registered. The individuals indicted Monday had been certified by the Chicago Board of Election Commissioners as deputy registrars.

The eight are charged with filling out hundreds of audit sheets with the names of people never actually registered.

The Chicago Voter Registration

Coalition used the audit sheets to determine how much to pay each deputy registrar.

The indictment charges that Robert B. Williams Jr, 34, of 6700 South Shore Drive, a former Water Department employee, reaped nearly \$32,000.

Also indicted on charges of theft, perjury and mutilation of election materials are Steven Jones, 32, of 5839 N. Maplewood Ave.; Elizabeth Hitler, 26, of 6848 S. Cornell Ave.; Virginia Gipson, 25, of 4024 W. Division St.; Patricia Sistrunk, 30, and Ziff Sistrunk, 35, both of 6000 S. Indiana Ave.; Anell Henry, 37, of 4236 S. Cottage Grove Ave.; and Jonathan O'Neal, 29, of 3615 S. Michigan Ave.

THIS ARTICLE APPEARED IN LAST WEEK'S TRIBUNE. WE WANT TO FORM A TENANT ORGANIZATION THAT IS MORE INTERESTED IN IMPROVING LIVING CONDITIONS IN THIS BUILDING THAN ONE THAT IS TRYING TO SELL IT. IN THIS WAY, YOU ARE MORE GUARANTEED OF HAVING A PLACE TO STAY.

PATRICIA SISTRUNK
WAS THE LEADER
OF THE TENANT
ORGANIZATION AT
THE BEGINNING

60

Chic.

George C. Graham

August 6, 1992

U.S. Department Of Housing
and Urban Development
Chicago Regional Office, Region V
77 W. Jackson, BLVD
Chicago, Illinois 60604-3507

RE: 6000 Indiana Apartments
Project No. 071IL 55 119

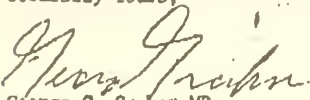
WORKOUT PLAN FOR BRINGING THE MORTGAGE CURRENT

Dear Sirs:

I am requesting that you substract \$31,000 from the mortgage delinquency which represents delinquent replacement reserve funds. I have \$40,000 in the replacement reserve and I am requesting that you substract \$15,000 from that to be applied to the delinquency amount, leaving \$26,000 which represents slightly over two months delinquency which can be paid out at \$5,000 per month over a six month period.

A HUD form demonstrating these payments is accompanying this letter. This form is in accordance with the handbook #4350.1CHG-54.

Cordially Yours,


George C. Graham, MD

lrg

*L. ELWOOD**George B. Graham*

Indiana Terrace Tenant Organization ITTO

6000 Indiana Building Meeting

Tuesday, April 7th, 1992

6:00 P.M.

Apartment 602

Draft AGENDA

- | | |
|---|------------------------|
| I. Call to order | Valerie Gibbs (5 min) |
| II. Reading of last minutes | Vicki Mack (5 min) |
| III. T.A. Consultants report | Pat Sistrunk (10 min) |
| IV. By-Laws formation/Incorporation fees | Valerie Gibbs (15 min) |
| V. Organization development | Pat Sistrunk (10 min.) |
| VI. HUD Planning Grant (dead line April 15th) | Group Discussion |
| VII. Open Tenant owned Laundry Mat | Group Discussion |
| VIII. Questions /Answers | Group Discussion |
| IX Closing Remarks | |
| X. Adjournment | |

Refreshments Served

For more info ask *George C. Graham*
 or write in #1001. Pat in #1002

Hear the real de

This is to confirm the fact that we, tenants of 6000 S Indiana Chicago, Illinois are not a part of the suit filed against the Department of Housing and Dr. George Graham filed by the Indiana Terrace Tenant Organization through the Legal Assistance Foundation. Our signatures below confirm this fact.

APT

101	vacants served	505 Mary Briggs
102	W. Davis - Martin	506 Simmons
103	Vacant	601 (if you found anything else, it's dead.)
104	Officer E. Davis	And 602
201	Arley Smith	603
202	Delora Reed	605 Henry Russell
203	Thomas Boyd	606 Linda Kelly
204		607
205	Vacant	Hear the real de
206	Patricia Hopkins	703
301	Gyretu Dingo	704
302		705
303		706
304	vacants served	801
305	Chris. T. Lombard	802
306		803
401	Coretta Johnson	804
402	Coretta Johnson	805
403		806
404	Relanda Davis	901
405	F. Williams	902
406	Frank X. Miller	903
501	James Ryan	904
502	Ma Helen Webb	905
503	Epicka Basswood	906
504	Hammett M. Smith	1001
		1002
		1003
		1004
		1005

HOMER AND LUD

George C. Shadwin M.D.

DRIVEN

110 Patricia Wiley

1102

1103

1104 Wynette John

1105

1106 Jim Richardson1201 Norma Reeves

1202

1203

1204 Vacant1205 Daniel L. Pierce1206 Desiree M. Stewart

George C. Graham MD

**Indiana Terrace Tenants Organization
I.T.T.O.**

BUILDING MEETINGS

at

6000 S. INDIANA AVE.

APT 602

THURSDAY JANUARY 16TH 1992

TIME: 6:00 P.M.

**CAN WE BECOME OWNERS
OF THE 6000 INDIANA BUILDING?**

**ARE TENANTS SERIOUS ABOUT
IMPROVING OUR LIVING CONDITIONS?**

**Don't believe the -hype-
come to this meeting.
Hear the real deal...**

**INVITED GUEST: The Leland Group LTD
Property Development Consultants**

Refreshments served

**(If you must bring your kids)
And bring a chair**

**For more information,
Contact Vickie In #1001, Pat In #602, or Valarie In #901.**

Mr. PETERSON. Thank you. I have some questions, but we will get to those after we get the other witnesses' testimony here.

Next, we have Mr. Orehek. You are the general partner for the Edgewood Terrace Apartments I; is that correct?

STATEMENT OF JOHN M. OREHEK, GENERAL PARTNER, EDGEWOOD ASSOCIATES, DESIGNATED REPRESENTATIVE OF SP PROPERTIES 1982 LIMITED PARTNERSHIP, THAT OWNS EDGEWOOD TERRACE APARTMENTS, WASHINGTON, DC, ACCOMPANIED BY ROY LEE III, ASSOCIATE COUNSEL, SECURITY PROPERTIES, INC., SEATTLE, WA

Mr. OREHEK. Mr. Chairman, thank you.

Mr. PETERSON. Welcome to the committee.

Mr. OREHEK. Committee members, I am actually a general partner of a general partner of the general partner of Edgewood Associates.

Mr. PETERSON. You are the closest one they could get? You are way down here at the bottom of the chart. This looks like Senator Dole's chart on medical care and you are way down at the bottom.

Mr. OREHEK. They are complicated structures, but they seem to work most of the time.

Edgewood was acquired by Edgewood Associates Partnership back in 1982. It was about 12 years old at the time. It went through a needs assessment on our part before we acquired it. The transfer was approved by HUD from an existing partnership to ours. It is important to understand a little bit more about the project. It is in seven different buildings. One is a mid-rise building, and then there are six buildings of garden style, two and three story.

Now, these are all spread out over about 6 acres, and those 6 acres are bordered at least on two sides by public streets in the northeast quadrant of the city of Washington, DC. The property has an underlying 221(d)(3) mortgage that is, I think, about \$4.8 million principal as of the end of last year, outstanding \$4.8 million principal.

I mentioned before that the property's location is in the northeast quadrant. It is in a difficult transitional neighborhood. The property, and most of the information that I am going to give you—about the property, is based upon data as of the beginning of this year or the end of last year, 1993, because we have not had direct involvement with the property since that time. HUD has been in charge of the property since that time, and they have contracted with another management agent to watch the property and manage the property.

As of that time, however, 48 percent of the units in the building or in the buildings were occupied, and not incoincidentally about 48 percent of the units in the building had Section 8 associated with it. The balance are available to market rate renters. With respect to the tenant population, it is important to note that approximately 80 percent of the tenant population consists of families, and most of these families are single-parent families.

The remaining 20 percent or so is elderly and there is a very high density of children onsite. I say these things to give you some perspective of the amount of activity that goes on, the type of wear

and tear that you are going to generate on a project that has a family orientation rather than an elderly.

It is very important to note the unit mix because we believe that this has been a very major contributing factor to the difficulties that the property has experienced. The unit mix ranges from efficiencies with one bath to four bedrooms. We have about 177 of our total 292 that are one-bedroom and two-bedroom units, and then about 115 are three and four bedrooms, so the larger units commanding larger rents, are actually a lot more difficult to market without associated Section 8.

The property was acquired in 1983. An affiliate has managed it up until January 1994, and during that period of time we have not made a profit on the project. In addition to the money that the partnership invested in rehabilitating the project at the time it was acquired, which was, I believe, in excess of \$300,000, the partnership has invested an additional \$600,000 plus of its own money into the project, and affiliates of the partnership have not taken management fees to the extent of around \$450,000. When you combine that with whatever soft costs there are, such as our oversight expenses, we think we have in excess of \$1½ million invested in a project that has a \$4 million mortgage.

I think it is fair to point out at this point that on the video it indicated that there was approximately a half a million dollars or \$550,000 or so of government subsidy to the project last year. There was a total gross rental income, I believe, of about \$1½ million in 1993 when you combine the Section 8 subsidy with the rental collections from the tenants.

Of the half a million dollars, approximately \$200,000 went into security costs alone, and that was probably not enough. Edgewood has been struggling. Why? Primarily for two reasons. No. 1, I don't think anyone has anticipated the extent of the neighborhood change primarily as a result of the growth of the drug business that we as a Nation have and experienced.

Our property has very easy ingress and egress, and it is extremely difficult and costly to secure. It has become a drug haven, especially in the garden style buildings which are the larger bedroom unit buildings and therefore were harder to rent. Those buildings had a drug-associated use.

In addition to the crime problem, which we were not anticipating at the time that we bought the building nor could we adequately fund after what I will discuss with you our many trips to HUD, we had one of our major tools, one of our major weapons in our war in how to deal with these projects taken away from us in 1986 when the tax law was changed. Up until that time when we were experiencing a problem, such as a financial problem with a property, we were able to go out and bring in new investment dollars. These dollars could be used independently or in conjunction with some HUD program to solve the current problem, whether it was a deficiency in the building or additional security. Lacking that tool we were reliant on HUD, and our own limited resources, which, as I expressed, we put in quite a few dollars to combat this problem.

It is probably best that I give you some detailed analysis or detailed review, historical perspective, if you will, on what happened. It won't take too long. As I mentioned, we had struggled for quite

some time with the crime, the vandalism that resulted in people moving out. That resulted in mounting payables. That resulted in more difficult time dealing with vendors. That resulted in them charging us probably more because of the risk that they were taking in providing service to the project, et cetera. It had a snowball effect.

In addition to that or during that time, we always tried, endeavored to comply with all of HUD's regulations and attempted to provide the residents with as decent and safe and sanitary housing as we could under the conditions. The property, as of December 31, 1993, did not meet HUD's housing quality standards, and it is currently in need of extensive renovation, estimated to exceed \$10 million, and the property must obtain additional financing to address its physical requirements.

As I mentioned, the property is located in a neighborhood with a high demand for Section 8 units, but with really no demand for larger, unsubsidized, below-market interest rate units, of which we have 52 percent of our units.

From early 1989 through the summer of 1992, Edgewood approached HUD on numerous occasions with requests for additional HUD Section 8 loan management set-asides and emergency Section 8 funding. Additionally, we approached HUD for management improvement operations plans acceptance and for a HUD Section 241 capital improvement loan.

In both of those cases, we were prepared to put in additional financing if HUD would step to the line with a percentage of the financing. We applied for additional Section 8 units on March 22, 1989, on July 20, 1990, on July 10, 1991, and February 24, 1992. We did not get the additional Section 8. We continued to pursue—noting the physical deterioration of the property, we continued to pursue other options, as I mentioned, the MIO plan, and those were not approved.

In March 1992 and in June 1992, and then several days thereafter in June 1993 and September 1993, HUD issued management review or physical inspection reports which gave unsatisfactory ratings in the conditions of the operation of the property. We submitted numerous appeals and responses to their reports clarifying them, addressing the concerns, and to this date, July 26, 1994, we have not received any formal acknowledgment or response to our appeals and responses.

We have additionally been attempting to work to transfer the property to a nonprofit, which if it can gain financing to acquire the property, could hopefully renovate it and turn it around. We have been working with that nonprofit and with HUD to accomplish that. To date, we have not reached a successful conclusion to that.

Mr. PETERSON. Could we wrap it up now? Mr. Shays has to leave, and we will get to more details in the questions unless there is something more that you need to add.

Mr. OREHEK. There is more, but I will be prepared to talk about it later.

[The prepared statement of Mr. Orehek and the organizational chart referred to follow:]

Testimony of
John M. Orehek, Designated Representative
of SP Properties 1982 Limited Partnership,
General Partner of Edgewood Associates

Prepared for the
Committee on Government Operations Subcommittee
on Employment, Housing and Aviation
Relating to Conditions In and the Management of
Section 8 Project-Based Housing
The Honorable Collin C. Peterson, Chairman

July 26, 1994

Dear Mr. Chairman:

The following responds to Paragraphs 1, 2 and 3 of your July 9, 1994 letter requesting testimony on Edgewood Terrace Apartments, located in Washington, D.C.

RESPONSE TO PARAGRAPH NO. 1:

I. **BACKGROUND INFORMATION**

Edgewood Terrace Apartments (referred to as "Edgewood I" or "the Property") is owned by Edgewood Associates, a District of Columbia limited partnership ("Edgewood"). The general partner of Edgewood is SP Properties 1982 limited partnership. Edgewood acquired the Property in March of 1983. The 292-unit complex was built on 5.97 acres in 1972. It is constructed of reinforced concrete and masonry. There is one mid-rise building which is seven stories high and six garden apartment buildings. The garden apartments are constructed of the same materials as the mid-rise building.

Edgewood I was financed under Section 221(d)(3) of the National Housing Act with a First Mortgage in the principal amount of \$4,687,407 as of December 31, 1993, and a Second Mortgage in the principal amount of \$176,528 as of December 31, 1993. In addition, there is also an

outstanding acquisition note to the March 1983 Seller in the principal amount of \$1,360,000 as of December 31, 1993. Under terms of the Regulatory Agreement with the United States Department of Housing and Urban Development ("HUD"), distributions to the owner were limited to 6% per annum of defined equity. No distributions have ever been made to the owner, as Edgewood I never made a profit.

II. LOCATION/NEIGHBORHOOD

Edgewood I is located in Northeast Washington, DC.

Public bus service is available along Edgewood Street and there is a subway station six blocks from the Property. The subway provides service to the downtown area of the city as well as the Maryland and northern Virginia suburbs.

The Property is located in a neighborhood known as the Edgewood District, which is generally regarded as a low income, high crime area. The neighborhood is primarily residential with some limited commercial uses in the surrounding area. Edgewood I has a District of Columbia elderly public housing complex to the North, and a HUD Section 236 high rise complex to the West.

III. PROPERTY INFORMATION

The gross floor area is 215,410 square feet with 157,084 square feet as residential rentable area, 24,635 square feet as commercial rentable area, and 33,691 square feet as common area.

As of December, 1993, Edgewood was approximately forty-eight percent (48%) occupied.

Eighty percent (80%) of the tenant population consists of families (most of which are single parent families), with the remaining twenty percent (20%) being elderly. There is a very high density of children at this Property.

As of December 31, 1993, the commercial space was approximately 80% occupied by the D.C. Department of Human Services, a delicatessen, a recreation center and a supermarket.

At the time the Property was constructed, it was HUD's policy to require a substantial number of large family units. The type and size of the units located on the Property are summarized in the following table:

<u>Type of Unit</u>	<u>Number</u>	<u>Sq. Feet</u>
Efficiency/1 Bath	20	455
1 Bedroom/1 Bath	81	590
2 Bedroom/1 Bath	76	795
3 Bedroom/1 Bath	43	925
4 Bedroom/2 Bath	72	1,235

There is a central laundry facility in the mid-rise on the basement level and each of the garden apartments has individual laundry facilities.

Each unit has a kitchen equipped with a gas range, refrigerator and garbage disposal. There is vinyl asbestos tile throughout the units. The efficiency, one, two and three bedroom units all have one bathroom with a commode, shower/tub and sink. There is a playground and swimming pool. The pool is closed due to lack of funds for necessary repairs.

All of the four bedroom units are located in the three-story garden apartments. All four bedroom units have two bathrooms and individual gas heating and cooling systems.

Rent payment includes electric heat, air conditioning, lighting and gas.

IV. SECTION 8 INFORMATION

	<u>Units</u>	<u>Maximum Section 8 Contract Amount</u>	<u>Section 8 Contract Amount Utilized</u>	<u>% of Units</u>
- Section 8 Contract No. DC 39M000077	56	\$257,795	\$231,885	(19%)
- Section 8 Contract No. DC 39000045	58	\$370,987	\$333,407	(20%)
- D.C. Section 8 & Tenant Assistance Payments	25			(<u>9%</u>)
				(48%)

Section 8 Unit Monthly Rents (1993):

a) Efficiency	\$489
b) One Bedroom	\$595
c) Two Bedroom	\$683
d) Three Bedroom	\$795
e) Four Bedroom	\$865

Rent increases are budget-based.

V. FINANCIAL INFORMATION AS OF DECEMBER 31, 1993

Operating Costs <u>Without</u> Debt Service (1993)	\$1,657,844
Annual Operating Costs <u>Including</u> Debt Service (1993)	\$1,815,236
Replacement Reserve Balance as of December 31, 1993	\$88,689
Computation of Surplus Cash, Distributions and Residual	
Receipts as of December 31, 1993	(\$2,926,436)

Although not required by the HUD Mortgage and Regulatory Agreement, property management fees of \$458,112 that were accrued through December 31, 1993 were waived by the affiliate management agent in an attempt to alleviate the financial strain. Edgewood or its Affiliates made voluntary advances to fund operating deficits as of December 31, 1993 totaling \$603,830.

Security Costs for 1993 were \$185,766.

RESPONSE TO PARAGRAPH NO. 2

Edgewood I has been struggling financially for several years. Mounting accounts payable, as well as vacancies, high unit turnover, rent collection problems, crime, vandalism and security problems, have plagued the Property. The physical condition has steadily deteriorated. Edgewood I is faced with the typical problems of a property over 20 years of age, with outdated and inefficient elevator, electrical, heating, cooling, and plumbing systems. Nonetheless, within the financial constraints

and limitations, Edgewood endeavored to comply with all HUD regulations and attempted to provide the residents of the Property with decent, safe and sanitary housing.

The Property, as of December 31, 1993, did not meet HUD's Housing Quality Standards and is currently in need of extensive renovation, estimated to exceed \$10 Million Dollars. The Property must obtain additional financing to address its physical requirements.

The Property is located in a neighborhood with a high demand for Section 8 units with no demand for unsubsidized Below Market Interest Rate ("BMIR") units. Fifty-two percent (52%) of Edgewood I's units are BMIR.

From early 1989 through the Summer of 1992, Edgewood approached HUD on numerous occasions with requests for additional HUD Section 8 Loan Management Set Aside ("LMSA") and Emergency Section 8, Management Improvement Operations Plans ("MIO Plans") and a HUD Section 241 capital improvement loan request. Edgewood applied for additional Section 8 units on March 22, 1989, July 20, 1990, July 10, 1991, and February 24, 1992. Edgewood recognized the physical deterioration of the Property and diligently pursued possible options for addressing the physical problems, including submission of MIO Plans to HUD in May, 1989. A revised MIO Plan was submitted in January, 1990 and resubmitted in June, 1990. In July, 1991, an application for a conditional commitment for a \$10,500,000 HUD 241 capital improvement loan was submitted to HUD to address the Property's long and short term physical needs. In October, 1991, the 241 capital improvement loan application was rejected by HUD, primarily due to the classification by HUD of a majority of the line items as deferred maintenance.

In March 1992, June 1992, June 1993, and September 1993, HUD issued either Management Reviews or Physical Inspection Reports which gave "Unsatisfactory" ratings in the conditions and operations of the Property. Edgewood submitted numerous appeals and responses to HUD's Management Reviews and Physical Inspection Reports. To date, HUD has never formally acknowledged or responded to any of Edgewood's appeals and responses.

In September 1992, HUD informed Edgewood that the Section 8 LMSA/Section 241 capital improvement loan proposal submitted by Edgewood and a local non-profit corporation was not approved. Accordingly, Edgewood informed HUD of its desire and intention to turn the Property over to HUD or its designee and to terminate property management by its affiliated agent. In the Fall of

1992, Edgewood defaulted on the first and second mortgages, which were subsequently assigned to HUD in the Summer of 1993.

During the Spring and Summer of 1993, the local non-profit corporation continued its efforts to obtain HUD approval for an acquisition/renovation program for the Property. While Edgewood supported that effort, Edgewood requested that HUD take the Property either through deed-in-lieu of foreclosure, foreclosure or mortgagee-in-possession.

On September 2, 1993, HUD again turned down a revised acquisition/rehabilitation proposal submitted by the local non-profit corporation. The local non-profit corporation subsequently appealed this decision to HUD-Headquarters where it is now pending.

Edgewood and HUD agreed to have HUD take possession and operating control of the Property pursuant to a Mortgagee in Possession Agreement dated December 22, 1993 ("MIP Agreement"). Pursuant to the MIP Agreement, all tenant security deposits, operating accounts, existing leases, service contracts, etc., were turned over to HUD, together with Edgewood's rights to collect and receive rents from the Property.

On January 14, 1994, HUD assumed operational control and management of the Property under the MIP Agreement. HUD is now responsible for the day-to-day operations and maintenance of the Property. Since operating control of the Property has been turned over to HUD, Edgewood does not have current information on such matters as vacancies, rent roll, current percentage of units that receive Section 8 assistance, and accounts payable.

RESPONSE TO PARAGRAPH NO. 3

Edgewood I became a troubled HUD project due to a combination of factors. First, a surrounding neighborhood where drug trafficking, crime and vandalism took over and made it impossible to protect the Property and its tenants from those forces. Second, a steady decline in the income levels of tenants and tenant composition that increasingly lacked family structure and stability. Third, the substantial difficulties in evicting delinquent and undesirable tenants under the laws of the District of Columbia. Fourth, a project design which combined large four bedroom garden apartment structures with a centralized mid-rise structure; as crime and vandalism took over the neighborhood, its first impact was on the surrounding low-rise units which, ultimately, made it virtually impossible to

adequately secure the mid-rise structure which contained the largest number of tenants. Fifth, with the advent of the 1986 Tax Reform Act and the loss of tax benefits to investors in low and moderate income housing, it became impossible to raise additional private capital to fund repairs, maintenance, capital replacements/improvements and increased security costs; following the Tax Reform Act of 1986, the Property became totally dependent on HUD and the flow of Section 8 subsidy for survival. Sixth, the inability of HUD to timely respond to rent increase requests, Section 241 capital improvement loan requests and Edgewood's proposal to convey the Property to a local non-profit corporation, which had successfully completed the acquisition and renovation of similar low-income properties. Seventh, Edgewood and its affiliates have advanced over \$1 Million Dollars to Edgewood I. Notwithstanding these optional advances, Edgewood simply did not have the resources to deal with the magnitude of the drug, crime, vandalism and security problems and the deteriorating physical condition of the Property. Eighth, HUD was not able to timely respond to requests for assistance or, ultimately, Edgewood's request for HUD's approval of the conveyance of the Property to the local non-profit corporation.

RECOMMENDATIONS

The brief chronology of events surrounding the Property as described in the "Response to Paragraph 2" above provides a sense of the efforts and frustrations encountered in attempting to deal with the physical and operating needs of the Property. The recommendations Edgewood would make as to how HUD can improve its assistance to owners and property managers with HUD properties similar to Edgewood I are as follows:

When HUD is made aware of the increasing impact of drugs, crime and vandalism on a HUD property, HUD should respond by joining the Owner in requests for greater attention and protection from local police authorities and should respond to requests for Section 8 rent increases to cover increased security needs or special loan assistance for the acquisition and installation of such security devices (electronic surveillance, fencing, etc.).

For properties such as Edgewood I, where both project design/configuration and original construction shortcomings contribute to declining physical condition and habitability, HUD should permit demolition of certain units, capital improvement grants, or "soft" capital improvement loans to owners who do not have the ability to raise capital to deal with such problems.

In the case of Edgewood I, the inability to obtain timely responses to requests for Section 8 rent increases from HUD was a major contributor to the decline of the Property. An owner and property manager of a property such as Edgewood I, which is in a rapidly declining condition due to surrounding crime, vandalism and lower-income tenancy, simply should not have to wait a year or longer for HUD to act on a rent increase request, a Section 241 capital improvement loan, or other legitimate requests for assistance. When HUD perceives a deficiency in an application, it should be addressed promptly and HUD should work with the owner to put the application into acceptable form.

When there is an opportunity for an owner to convey a property such as Edgewood I to a qualified locally-based, non-profit corporation with a track record for being able to rehabilitate and operate projects such as Edgewood I, HUD should "jump" at such a proposal.

The above comments on the lack of HUD responsiveness and inability to provide assistance are not intended to lay the blame for Edgewood I on HUD. In fact, loan management personnel at the HUD-D.C. Field Office are overwhelmed by the number of projects with problems similar to those of Edgewood I that they have responsibility for. In our view, it is impossible for HUD staff to effectively deal with projects such as Edgewood I, given current staffing and workload levels. There has got to be real recognition within the Congress and OMB that HUD cannot effectively manage its portfolio of HUD-owned properties and HUD-held mortgaged properties with the resources presently being made available. Problem properties such as Edgewood I are enormously consuming of HUD staff time and attention, and their problems are complex, difficult and frustrating to deal with. HUD has to get more resources focused on properties such as Edgewood I before they have fallen to the bottom rung of the affordable housing stock ladder.

Respectfully submitted,
EDGEWOOD ASSOCIATES

Supplemental Testimony of
John M. Orehek, Designated Representative
of SP Properties 1982 Limited Partnership,
General Partner of Edgewood Associates

Prepared for the
Committee on Government Operations Subcommittee
on Employment, Housing and Aviation
Relating to Conditions In and the Management of
Section 8 Project-Based Housing
The Honorable Collin C. Peterson, Chairman

August 5, 1994

Dear Mr. Chairman:

The following information supplements Edgewood Associates response to Paragraphs 1 and 2 of your July 9, 1994 letter requesting testimony on Edgewood Terrace Apartments, located in Washington, D.C.

SUPPLEMENT TO PARAGRAPH NO. 1.1:

The owner of the property is Edgewood Associates. Edgewood Associates is a District of Columbia limited partnership. Its general partners are SP Properties 1982 Limited Partnership ("SP Properties 1982") and Edgewood, Ltd. Edgewood, Ltd. is also a limited partner of Edgewood Associates.

The general partner of Edgewood, Ltd. is SP Properties 1982. The limited partner of Edgewood, Ltd. is Combined Properties Limited Partnership ("Combined Properties"). Combined Properties is a Washington state limited partnership formed to invest in several real estate properties. The general partner of Combined Properties is also SP Properties 1982. The limited partners of Combined Properties are various individual investors.

The general partners of SP Properties 1982 are Paul H. Pfleger, SP Consolidated Limited Partnership ("SP Consolidated") and MAE-SPI, L.P. SP Consolidated is also a limited partner of SP Properties 1982. SP Consolidated's general partners are Paul H. Pfleger, John M. Orehek, and John Taylor. The limited partners of SP Consolidated are individuals.

The purchase price for Edgewood Terrace I was Eight Million Seven Hundred Twenty-Five Thousand Seven Dollars and No/100 (\$8,725,007.00). The purchase price was paid as follows:

- (a) \$6,116,400 by assumption of two HUD insured mortgages
- (b) \$2,158,607 Promissory Note
- (c) \$450,000 cash at closing

As of December 31, 1993, the outstanding balance due under the Promissory Note identified in Paragraph (b) above was as follows:

\$1,360,000	Principal
<u>2,719,994</u>	Accrued Interest
\$4,079,994	Total Due

The Promissory Note was paid down from the limited partners' capital contributions rather than operating income.

As of December 31, 1993, the outstanding principal of the two HUD insured mortgages was \$4,863,935 and accrued interest was \$221,211.

The records of Edgewood Associates and Edgewood, Ltd. indicate that their respective partners have received, as of December 31, 1993, tax loss allocations in excess of \$11 million. However, a substantial amount of these tax losses were incurred subsequent to the 1986 Tax Reform Act and therefore may not have been fully deductible by the partners. In addition, upon foreclosure of the property or the issuance of a Deed in Lieu of Foreclosure to the United States Department of Housing and Urban Development, which is expected to occur within the next few months, the partners of Edgewood Associates may be required to recapture those tax losses which were deducted that were in excess of their original capital contributions to Edgewood Associates or Edgewood, Ltd. It is estimated that the tax recapture to the partners may be in excess of \$8.7 million which may be taxed at their individual rates.

SUPPLEMENT TO PARAGRAPH 2:

For your information, please find a copy of the HUD Mortgagee In Possession ("MIP") Agreement dated December 22, 1993.

Respectfully submitted,

EDGEWOOD ASSOCIATES



U. S. Department of Housing and Urban Development

Washington, D.C. Field Office, Region III
 Union Center Plaza
 820 First St., N.E.
 Washington, D.C. 20002-4205

Mr. Paul Pfeleger
 and Mr. Russell Lomax
 SP Properties 1982 Limited Partnership
 1601 Fifth Avenue, Suite 1900
 Seattle, Washington 98101

Re: Project Name: Edgewood Terrace Apartments
 Location: 601 Bryant Street, N.E.
 Washington, D. C.
 Project Number: 000-55095-LD

Dear Sirs:

This letter, when properly executed by authorized officers of SP Properties 1982 Limited Partnership (herein called the "Mortgagor"), shall constitute an agreement between the Mortgagor and the Secretary of Housing and Urban Development (herein called "Secretary"), acting by and through J. Hugh Allen, Director, Housing Management Division, with regard to FHA Project No. 000-55095 (herein called the "Project").

WHEREAS, the Mortgagor has failed to make payments owed to the Secretary under a Mortgage Note secured by the Project, and has been duly declared to be in default by the Secretary;

WHEREAS, the Regulatory Agreement entered into between the Mortgagor and the Secretary provides that the Secretary may take possession of the project after each default by the Mortgagor;

WHEREAS, the Mortgagor and Secretary wish to provide for the orderly and peaceable transfer of the possession and management of the Project from the Mortgagor to the Secretary,

NOW, THEREFORE, the Mortgagor and the Secretary agree as follows:

1. The Mortgagor will deliver to the Secretary or his agents possession of all the property, real, personal or mixed, associated with, derived from or used in the operation of the Project.
2. The Mortgagor and his agent will refrain from interfering in any way with the possession, preservation, operation and management of the Project by the Secretary or his agents.

3. The Mortgagor hereby assigns to the Secretary the right to collect and receive all rents, charges and profits from the Project. The Secretary agrees to use this Project income to pay necessary expenses for operating and preserving the Project and to also pay the Mortgagor's obligations under the Note and Mortgage when Project income exceeds operating expenses. When operating expenses exceed project income, any advances made by the Secretary will be added to the outstanding indebtedness due and payable under the Mortgage.
4. The Mortgagor shall deliver to the Secretary forthwith, but in no event later than the date HUD places its contract manager on site, the following:
 - (a) All funds held as tenant security deposits, along with an accounting for each tenant of the amount collected and date of collection.
 - (b) All funds in Project operating accounts, reserve fund accounts and any other accounts derived from or associated with the operation of the Project.
 - (c) All existing leases entered into between the Mortgagor and the current tenants of the Project and a schedule of current rental rates.
 - (d) All supplies, furniture, equipment and other personal property associated with the Project.
 - (e) All existing service contracts of the Project including, but not limited to, contracts for landscaping, pest control, metered laundry equipment, air-conditioning and heating.
5. The Mortgagor will preserve all financial records, books of account and related materials and make them available to the Secretary for inspection at any time. The Mortgagor will also provide the Secretary with a final financial accounting for the project covering the period from the Mortgagor's last audited financial statement to the date of possession by the Secretary. This accounting must be prepared by an independent public accountant and certified by the accountant and the Mortgagor in accordance with the requirements of HUD Handbook 4372.1. The Mortgagor shall provide this accounting by March 1, 1994.
6. The Mortgagor acknowledges that the Secretary may act as the agent of the Mortgagor and any other party who has ownership interest in the project when necessary to carry out all management functions at the project, such as tenant evictions and rent increases, which are reserved to property owners by state law.
7. The Mortgagor acknowledges that the Secretary, in taking possession of this project, assumes none of the liabilities, costs or expenses incurred by the Mortgagor prior to the taking of possession by the Secretary.

8. The Mortgagor acknowledges that the actions detailed herein are to be taken without prejudice to a waiver of any right of the Secretary in any matter that has or may rise in connection with the Project.

Secretary of Housing and
Urban Development

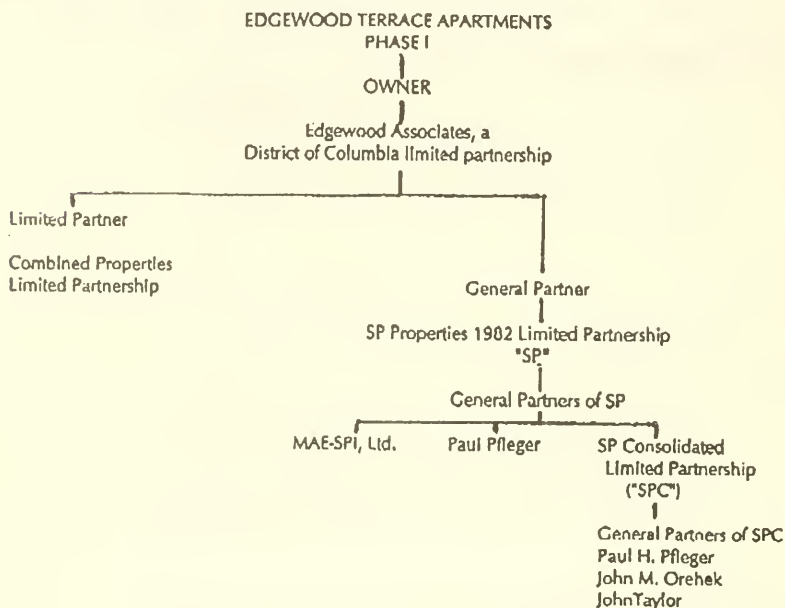
Mortgagor(s):

By: J. Hugh Allen
Title: Director
Housing Management Division
Date:

By: Edgewood Associates,
SP Properties 1982 Limited Partnership
Title: General Partner
Date: December 22, 1993
By: Paul H. Pfeiffer
Title: Managing General Partner
Date: December 22, 1993

ORGANIZATION CHART FOR OWNERSHIP OF EDGEWOOD TERRACE APARTMENTS
TO ACCOMPANY THE TESTIMONY OF JOHN M. OREHEK

SUBJ: Ownership Structure - Edgewood Associates



Mr. PETERSON. Mr. Ford. Appreciate you being with us.

STATEMENT OF EUGENE F. FORD, PRESIDENT, MID-CITY FINANCIAL CORP., AND OWNER OF EDGEWOOD MANAGEMENT CORP., EDGEWOOD TERRACE APARTMENTS II, WASHINGTON, DC, ACCOMPANIED BY ELLIOT BERNOLD, PRESIDENT, EDGEWOOD MANAGEMENT CORP.

Mr. FORD. My name is Eugene Ford. I am president of Mid-City Financial Corp. and the owner of Edgewood Management Corp. I have with me Mr. Elliott Bernold, the president of Edgewood Management, as a resource. A biography of my qualifications and responses to the factual information concerning Edgewood II is in my written testimony, which I have submitted. I would like the opportunity to amend that testimony in light of the things I have heard here this morning and the committee's focus, if that is possible.

Mr. PETERSON. Sure.

Mr. FORD. Thank you. First, I would like to address what I think might be a couple of misperceptions. The first is that there aren't any good management companies out there. There are a lot of them. There are a lot of good ones. There can be a lot of reasons that a solution may not be available or something that a management company can control.

It may be that neither HUD nor the manager understand, or are getting to the root of the problem and therefore cannot come up with the solutions to be implemented. The problem is not that there are not good management companies, the problem is that there are some bad ones who do not address solutions or who create the problems and that these companies or owners are approved or allowed to continue in management or ownership. HUD has typically not acted soon enough to see solutions implemented by clearing out the managers or owners if they are not responsive.

The second misconception is that there isn't a lot of good assisted housing out there that works. There is a lot of good housing providing just what the programs are supposed to provide for the people served. There are a lot of tenants enjoying that, and I will tell you that if I were to give you a list of the properties that we built and owned and managed that you could go to any one of them and they are as good or better than any conventional projects in the area, and I don't think it is that uncommon. There are a lot of very good practitioners in the business. We have been in it 35 years.

The task of managing assisted properties, particularly in the inner city, has become more complicated and requires skills that all management companies do not possess. HUD must raise its standards for the approval of managers of assisted projects and require performance under pain of loss of management or other penalties.

If HUD has a problem defining these standards, I suggest that they seek the help of the National Association of Assisted Housing Managers or other industry groups who could also help them on a continuing basis. A consulting board or boards of qualified industry members could be set up that could make recommendations to HUD on core problems and for taking appropriate actions to discipline management companies. There is precedent for this in other industries, probably the extreme is the NASD, but there is some modicum or variation of that that would be very useful to HUD.

here because there is a lot of experience out there. My belief is that experienced and capable firms would respond.

HUD has to develop a program to attract and retain people with the potential for significant service to HUD. The environment in HUD for the last 15 years has not been conducive to this objective. I took two highly educated people from HUD in the early 1980's, one of whom is sitting here, and they became president of companies of ours.

In my opinion, these fellows wouldn't have left HUD had conditions created by the various administrations and by legislation, offered them what they believed to be the opportunity for a real contribution in their careers at HUD. You must strive to put this factor back into the HUD environment.

I know that HUD is reaching out to do more and a higher level of staff training. We have supported the development of a program with the University of Maryland on a curriculum for professional training for their people and which they hope to broaden around the country. You shouldn't stint with funds that they request to accomplish that task, I think.

HUD should learn to utilize competent management companies more than they do. There is a lot of heady tasks taking up a lot of time and attention, and diversion from priorities that they ought to have that could be very easily put out to competent companies based upon their performance. I am thinking of such things as approval of replacement reserves, the setting of rent, set whatever strict standards and penalties you want, but there are a lot of people out there who can do the job as well or better than HUD and save everybody, HUD and the managers, a lot of grief, and hold them responsible.

We have addressed in page 13 and 14 of my written testimony some issues on HUD oversight and how to improve it. They are understaffed, they are undertrained. They have been given a whole load of new responsibilities in recent years. They have three-quarters of the people involved nonhousing matters, only peripherally related to operating and insuring property.

I think their process has to be drastically changed and with the suggestion I have made here.

HUD has a huge portfolio of BMIRs and 236's in the LIHPRA program as well as projects insured in other programs that are owned by people who haven't a motive in the world to continue in ownership other than to hope that they can keep the project out of foreclosure until they die. Because of the owners negative basis, there is not enough equity for solutions, either under LIHPRA or ELIPRA to pay the tax on a sale. It is not in the public or the tenants interest that they remain in ownership. Legislation to relieve these owners of the tax on their negative basis, if the title were transferred to HUD, or a HUD approved entity, would give HUD a strong tool for more timely resolution of troubled projects.

HUD could act much quicker toward resolution of problems if they had that tool, and I recommend that you consider that. Mr. Bernold just made a comment that we are probably going to amend our testimony a little bit to include some comments about some of the IG's remarks here. They are not perfect, either, and, however, I am sure they are useful.

Earlier, the chairman talked about looking at the big picture. I think the delivery systems of a lot of things related to successful housing need to be fundamentally and structurally changed, both at the legislative level and the level of the various agencies responsible.

Shelter and housing is one aspect of what comprises an urban neighborhood, other big factors for people are security and education for their children. If you are going to address the fundamental issue of keeping people with housing options in urban neighborhoods, the delivery systems that we have today for the various services that are needed have to change. Change will not occur until congressional committees and Federal agencies communicate much more to develop comprehensive approaches.

For instance, I would have asked Mr. Retsinas, just how much HUD talks to HHS who administers education, daycare, welfare programs, and job training, all these things that happen to families that are living in HUD projects.

Our company has spent a lot of time in development of and facilitating social support programs in our management company. We have about 25 people doing that, and I will tell you, I think there is a real opportunity to put needed services, even down to case management, right down at the project level so people aren't wandering all over town worrying about daycare and transportation. Put the services right down there so it is across the hall or in the next building.

With the types of computer systems available today, if systems were related to desired services close to home and the family, they could be made effective.

To go back to the issue of staffing and training of HUD employees, it is particularly important because the government has billions at stake in the upcoming renewal of Section 8 contracts. This is a \$9 billion per year program and it is vital that HUD negotiators understand the real alternatives the parties have. It is likely that HUD should get the professional help it needs from out sourcing since I do not believe they can develop qualified staff quickly enough. Thank you.

[The prepared statement of Mr. Ford follows:]

WRITTEN TESTIMONY OF EUGENE F. FORD

PRESIDENT OF MID-CITY FINANCIAL CORPORATION

BEFORE

SUBCOMMITTEE ON EMPLOYMENT, HOUSING AND AVIATION

JULY 26, 1994

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FORD BIO

I am President of Mid-City Financial Corporation, a successor to a business founded in 1965 to be responsive to public purpose housing programs for low and moderate income families; an objective which we still pursue today. We have been involved in the development of 48 projects in various programs totaling approximately 12,000 units.

An affiliated company, Edgewood Management Corporation, was formed in 1973. Its activities include property management, construction management services, resident construction coordination services, and resident social and educational programs. Currently, Edgewood manages 73 projects totaling about 15,000 units. All of these properties have some degree of rental restriction related to low or moderate income use. Sixty-three (63) of the properties have some Section 8 or RAP tenants of which thirty-three (33) are 100% Section 8. We are most honored to have recently received the 1994 Commissioner's Award from the Department of Housing and Urban Development which states "For your significant contribution to HUD'S mission to help people create communities of opportunity".

I believe all of our projects meet and exceed HUD Housing Quality Standards.

SUMMARY

My name is Eugene Ford. I am President of Mid-City Financial Corporation. My wife and I own Mid-City Financial Corporation and Edgewood Management Corporation.

Mr. Chairman and members, I thank you for this opportunity to address the focus of your concerns as to how HUD intends to improve the management of troubled properties and how to address the problem of providing excess subsidies to owners of some projects.

You have asked me for a history of my involvement with Section 8 project based housing and for specific information on Edgewood Terrace II. This factual information is contained on pages two and three of my submitted written testimony, which I request be made a part of the record of the hearing.

In my spoken testimony, I will address the subjective issues requested in your letter to me.

The first comments requested were my views as to why some HUD properties are troubled and do not meet housing quality standards. There are plenty of reasons within your power to influence, while

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others are not. The former includes bad underwriting, bad management, unenforced regulations, bad owners, bad HUD policies, and many uncontrollable factors as culture and neighborhoods change. Among the causes I have addressed in my written statement are:

- A. Root problems lie in FHA'S role as mortgagee and HUD'S role as provider of low income rents and other benefits to targeted income groups. This conflict exacerbated by legislation and failing delivery systems, tends to prolong and increase problems in troubled properties.
- B. Problem of inadequate reserves.
- C. FHA does not have high enough standards for qualification or performance for management of these properties.
- D. HUD rules and regulations are not adequately enforced. They do not intervene in management and mortgage problems with definitive action

SUMMARYPage Three

soon enough. HUD's expectations are not high enough. This reflects the pull or sometimes conflicting motives of HUD, the mortgage insurer, and HUD, the administrator of a myriad of legislated public objectives. Sometimes HUD is put in a position of having to make insurance and public interest decisions, both of which are bad. The skill to make these decisions has to be of high quality and reflect experience. The number of people capable of this in HUD is limited and varies greatly from office to office.

E. FHA staff is inadequate in number and has the wrong priorities given their work load.

F. Annual adjustment factors are a bad way to deal with projects. Some projects need budget based rents now.

G. The ownership of many properties is unsuitable for the public objective and tenant satisfaction.

SUMMARYPage Four

The problem of excessive subsidies is addressed first as programatic with built-in structural problems requiring fixing as many renewals are coming up and perhaps should be done even sooner. Secondly, HUD is not getting the benefits it should from refinancing of many higher rate mortgages. Third, many projects rehabbed in the inner-cities were done to save HUD from taking an immediate mortgage loss and instead perpetuated many poorly planned 40 year old, functionally obsolete, units into the next century at high cost. Considering their present form they should have died so that effective renewal could have taken place.

As to why our projects are managed effectively; technique, philosophy and commitment are all very important. There is little margin for error in managing the tension between keeping rents low and keeping projects healthy. It takes relentless attention, experience and control monitoring and is not a business for amateurs. Not all management companies managing troubled properties are bad managers by a long shot. There are many outstanding management companies around the country running Section 8 projects. HUD policies and procedures do not utilize all of their talent and capacity.

SUMMARYPage Five

The problem of excessive rent subsidy is addressed as caused by various built-in programatic problems. More specifically Annual Adjustment Factors in contract rents, unrealistic reserves in some state Section 8 programs, and failure to capture the benefits of lower interest mortgage and bond financing. It is vital that HUD be adequately staffed to administer the renewal or non-renewal of the upcoming Section 8 control. With competent people exercising real estate sense, unwavering use of proper market comparable rents as criteria, and a willingness to give people vouchers, if necessary, the government will save billions of dollars over the contract renewal period. All future adjustments should be budget based. The NHT and NHC studies contain well thought out policy options. Many of the rehab projects in inner-cities never should have been done. They resulted in outlandish costs and rents for an obsolete product that never should have been perpetuated into the next century. This is still going on right now. Policies are not in place to prevent this. Furthermore, it is my observation that Section 8 rent administration by local agencies has resulted in the worst rent abuses and is still going on today.

In general, HUD has to get some real estate sense back into its

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regulations and staff if its wants to control costs. They must stop regulating by formulas. They should delegate responsibility to highly qualified management companies with a performance record, then monitor compliance with specific law and regulations and overall performance. Put this burden on the owners and qualified managers under penalty of loss of management and fines. The most qualified will accept the burden because it will help them accomplish their job with more efficiency. It will also help HUD with its' staff problems by enabling them to focus on solutions to important problems instead of a lot of unnecessary regulatory process.

If HUD has trouble establishing criteria for qualifying or assessing a management company's capacity or performance, I believe they could get effective assistance from the National Association of Assisted Housing Managers (NAHMA) and others in the industry on a continuing basis. No one is more concerned with bad management performance of this type property than competent committed companies in this field.

INFORMATION REQUESTEDONEDGEWOOD TERRACE APARTMENTS, SECTION II

1. Number of Units: 258
 - Percentage of Section 8: 40% (103 units) HUD Project Based
 2.1% (8 units) D. C. Sec. 8
 .8% (2 units) TAP
 - Section 8 Annual Contract Amount: \$409,586.00
 - One-Bedroom Monthly Rent: \$490.00
 - Annual Operating Costs (1993) Including Debt Service: \$1,540,716.00
 - Per Unit Per Annum: \$6,000.00
 - Operating Costs Without Debt Service (1993) \$1,290,280.00
 - Per Unit \$5,001.00
 - Replacement Reserve Balance: \$170,210.00 (as of 6/30/94)
2. Rent Increases are budget-based.
3. Prior Years' Disbursable Surplus Cash: \$32,624.00
4. Allowable Distribution \$36,714.00

ASSESSMENT OF WHY SOME PROJECTS ARE TROUBLED

1. Many projects are troubled today because HUD has a dual role as a mortgage insurer and as a deliverer of low rents and a myriad of other benefits to targeted income and other classified groups. It has to work through a system where the property is privately owned by a single project entity structured, typically, as a limited partnership with little incentive and tenuous capacity to respond to capital needs. HUD has not acted soon enough or forcefully enough to resolve troubles quickly. Projects go downhill very quickly in some environments immeasurably increasing costs.

When troubles arise that require money for the projects to solve, such as the most common one of physical problems that cannot be corrected because of inadequate reserves (the root of which goes back to the 1960's and 1970's), HUD has developed a myriad of techniques over the years to address the issue. Among these techniques are (1) "flex-subsidy" with owner participation, which had very limited success because the limited return ownership entities were not structured or motivated to respond with capital and (2) LMSA Section 8, which was very effective in saving many troubled properties because it subsidized rents up to a level that existing tenants could not pay and the private market would not pay. In some cases, this had the problem of precluding new higher income market rate tenants

ASSESSMENT OF WHY SOME PROJECTS ARE TROUBLEDPage Two

or existing tenants whose income went up from renting. As a result, many of these properties have become 100% Section 8 and are impacted with a high imbalance of very low income families. Where there is a high concentration of such projects as in Southeast Washington, whole areas have simply become a place to warehouse the very poor since families with housing options will not move there.

Two other remedies which HUD has are, in my opinion, more effective and should have been and should be used more effectively (1) Foreclosure or (2) long term workouts with reduced debt service where the owners and managers are worthy. This will keep rents in line with the market and motivate existing and new tenants to remain.

Until recently, HUD foreclosure policy has been dreadful and immeasurably increased costs. Part of this is the ambivalence caused by HUD, the insurer, having to take an immediate hit and part is the inability of local HUD management staff to analyze the root cause of the problem or inability to make a decision and act on it. Congress bears a large burden for this problem due to a lack of understanding or political will as to the effect of foreclosure

ASSESSMENT OF WHY SOME PROJECTS ARE TROUBLEDPage Three

on the low income tenants, which certainly could have been mitigated in other ways than effectively precluding foreclosure. The rule requiring Section 8 for all the units HUD foreclosed and not providing adequate Section 8 funds was devastating. There is litter everywhere from this policy.

Recent legislation has modified this burden and HUD seems to be moving effectively toward resolving old problems.

If your concern is getting troubles resolved and long term costs mitigated, HUD's focus should be an early understanding of root causes of the problem, and quickly providing workouts responsive to the problem or foreclosing and restructuring with new owners in a structured sale. Procrastination and the inability to understand the cause of the trouble are your worst problems. Situations deteriorate rapidly in this environment. If you need outside expertise, direct HUD to get it and give them the money. It is the quickest and cheapest solution.

2. FHA standards for approval of managers of assisted projects are too lax. There is not enough emphasis on proven capacity to deal

ASSESSMENT OF WHY SOME PROJECTS ARE TROUBLEDPage Four

with assisted projects, particularly in the inner-city. Too often, managers have been approved simply because they were the owners or had raised the money and set themselves up to manage.

3. FHA rules and regulations are not adequately enforced. They do not intervene soon enough. Their expectations are not high enough. Misplaced concern for the effect on tenants of foreclosure immobilized FHA from utilizing its' most useful tool for resolution of troubled property and greatly increased costs. This is an example of the root problem discussed under Section 1.

4. FHA's staff is inadequate or has the wrong priorities. They get all tied up in trivial procedures, many of which could be delegated effectively.

5. Some projects that have annual adjustment based budgets should be changed to budget based rents. The rents are not adequate to properly operate the property. Future costs will increase. This problem also reflects the concern discussed in Section 1.

6. Existing ownership in many projects has no financial incentive

ASSESSMENT OF WHY SOME PROJECTS ARE TROUBLEDPage Five

to care for the projects. Their only motivation is to keep from getting foreclosed so that they are not taxed on their negative basis. It is not in FHA's or the tenants' interest that they remain in ownership. The project will suffer and so will the tenants. Tax relief on non-cash gains should be offered this type property in exchange for a deed to HUD or to a motivated owner-manager; public, non-profit or private.

7. Many central city projects were rehabbed under Sections 221(d)4 and 223-F that had very bad land planning and basic design obsolescence and never should have been perpetuated into the next century. An example would be the rehabbed 608's in Southeast Washington, which are almost 50 years old and which had Section 8 allocated to them because the market rents are so high that there is no market for them. People with higher incomes and who have housing options move into the counties at comparable or lower rent where the density is 60% of that found in these rehabbed buildings. The alternative has open space, is attractive, with more amenities (pools, clubhouses, etc.).

WHY OUR PROJECTS ARE MANAGED EFFECTIVELY
WHILE OTHER HUD PROJECTS ARE NOT

In short, the answer for us is technique, philosophy, and commitment.

Technique - We have very detailed procedures and tasks for on-site operation and extensive control systems to assure those tasks are performed. Examples would be in the fact that all of the tasks, monthly, yearly and beyond for maintenance and landscaping that will have to be performed are programmed well in advance. Each month the project gets a list of tasks that must be performed that month and the system is notified when completed. We inspect all units semi-annually with specialists, who are not the project employees, for evaluation, work orders and tenant discipline. A lot of training of on-site personnel is conducted. We know how many square feet of halls to be cleaned, how many square feet of grass to be cut, an average time to complete each task or work order and a system to monitor effective time utilization and responsiveness of on-site staff. Very little is left to chance and compliance with procedures and task is mandatory. We centralize accounting and income certification for control and performance reasons.

WHY OUR PROJECTS ARE MANAGED EFFECTIVELYWHILE OTHER HUD PROJECTS ARE NOTPage Two

Philosophy and Commitment - We have the benefit, in most cases, of having managed many of these properties from their original development. We are really vested in them. We can afford long term plans and approaches. We believe it is absolutely necessary to accomplish three things for a healthy project.

1. The public program's objective must be accomplished.
2. The tenants must get what they are supposed to get.
3. The investor gets what he is entitled to.

All our techniques and procedures are directed to these goals. We do not let the tenants, or the investors interfere with that and try not to let HUD do it either. We are really committed to this.

We believe that earning the confidence of good tenants by being responsive, professional and consistent is the best way to attract

WHY OUR PROJECTS ARE MANAGED EFFECTIVELYWHILE OTHER HUD PROJECTS ARE NOTPage Three

and keep the best tenants and create a positive attitude toward the treatment of the property. Our efforts to provide social activities and support to the various age groups and interests tends to increase tenant's satisfaction and attitudes.

We attempt to imbue this philosophy in all of our 550 employees. The significance of the importance of what they do is emphasized. The result of the employee spirit engendered is most apparent when you see the dedication from the on-site staff under what, in some locations, are very trying or even dangerous circumstances.

In the final analysis, if HUD and the cities support development that cannot compete with other housing options, which people with higher income have, there is no chance for mixed income communities in stable neighborhoods. You are simply warehousing the poor. HUD must become disciplined to use good real estate sense and reject any tendency to perpetuate infeasible projects at high rentals in order to keep its mortgages current. This is causing the Section 8 program to bear costs that the mortgage insurance fund should incur. .

PROBLEM OF EXCESSIVE RENTAL SUBSIDIES

I assume that your question concerning excessive rental subsidies is directed to the Section 8 New Construction and Substantial Rehabilitation Program.

There are a number of reasons for this.

First, in some instances, the high rent reflects the original rents necessary to support the project, which were higher than the market to begin with. In most cases, these rents are inflated by an Annual Adjustment Factor that was supposed to track inflationary increases in rent. However, in some jurisdictions the factor escalated the rents disproportionately to the actual increases in rents in comparable projects in the area. However, HUD's original non-administration or mal-administration of the Section 8 provision allowing it to reduce Section 8 project rents to those of comparable rents in the area led to court decisions inhibiting it's right to perform comparability studies and legislation preventing rent reductions because of comparabilities. HUD now has the right to perform such studies and should do so if it feels that Section 8 rent increases are too great.

PROBLEM OF EXCESSIVE RENTAL SUBSIDIESPage Two

Bear in mind that this is a relatively short term problem, in many cases, as the original contract will expire in the next few years. This year both the House and Senate housing bills address the extension of these contracts. This legislation reflects recommendations of the National Housing Council and the National Housing Trust studies, which had broader participation, and both include mechanisms to assure that renewal rents are fair, both in relation to the project's budget and to the real prevailing rents in the area. My own view is that there should be three (3) criteria adequate to deal with existing financing of HUD insured projects. A. Rents should not exceed true rent comparability plus a small factor built in to deal with program variables and B. Future rent adjustments should be budget based.

Second, some projects, particularly in rehab deals, were probably poorly underwritten in two (2) ways. (1) Insufficient rehab was done or (2) inadequate initial reserves were established for these older buildings. This underwriting results in higher utility, maintenance and replacement costs, which are either dealt with by higher rents, additional debt service or deterioration of the

PROBLEM OF EXCESSIVE RENTAL SUBSIDIESPage Three

projects' capacity to attract or keep tenants with housing options. My experience in the eighties was that while I did 4,000 rehab units, I was non-competitive in purchase pricing in many other deals because the proper long run rehab costs were not addressed by my competition who's purchase price was increased accordingly. Result! The seller walked away with the money instead of it being put into the property and FHA insured it.

Third, in many cases that seem to have excessive rents in relation to those in the area, the bonds which provided the original project financing have been refinanced at a significantly lower interest rate. Instead of lowering the monthly interest that the owner must pay as a result of the refinancing, HUD has devised a mechanism where the savings from the refinancing go either to the state housing finance agency, who originally financed the project, or directly back to the federal government. In other words, it is not the owner who is receiving the benefit of the high rents. You might get information and look at just how much money State Housing Agencies are pocketing from refinancing the mortgage bonds on Section 8 projects at lower rates with no reduction in Section 8

PROBLEM OF EXCESSIVE RENTAL SUBSIDIESPage Four

subsidy. There are, in fact, huge residual receipts accumulated and continuing to accumulate in many State Agency Section 8 housing deals, but bond indentures and the Section 8 contracts will probably not permit access to them or stop their further accumulation from Section 8 rents.

On the issue of addressing Section 8 contract renewals, I have no new suggestions not already contained in the Task Force and NHC Reports and pending legislation other than this. (A.) Upon renewal, properties providing excessive returns and having rents higher than the best comparables, should be abandoned if the owners will not bring the rents in line. (B.) All future adjustments should be budget based, including properties with automatic adjustments located in weak markets that have inadequate income. (C.) I sense that HUD might be able to make some advantageous deals with owners receiving high returns from above market rents by negotiating now several years before contract expiration. The most effective tool to accomplish this would be a longer term contract for lower rents starting now and budget based increases.

PROBLEM OF ESCESSIVE RENTAL SUBSIDIESPage Five

There are over 1.5 million project based Section 8 units having a total public outlay of 9 billion dollars per year. HUD is the steward of this enormous public outlay. For a variety of reasons it does not do a very good job. Congress should insist that it do its' job and HUD should let Congress know how much money it needs for qualified staff or outside help. This is particularly true as existing Section 8 contracts are coming due over the next several years. The dollars required to protect the investment by providing adequate numbers and quality of staff would be a tiny fraction of the 9 billion dollars spent annually and probably save billions of dollars over the term of the new contracts.

Fourth, changes in resident social and cultural conditions result in operating costs never anticipated. The biggest of these factors is the increasing need for security after the advent of crack cocaine and other drugs. Trends in liability for projects in the area of security and environmental matters will increase costs in the future. Money spent for drug prevention in projects is a cheap investment when the costs of losing that battle are considered.

A. IMPROVED HUD OVERSITE

HUD's problem of oversight of its projects essentially stems from being an agency that is not only understaffed, but the existing staff is untrained and lacks the knowledge and skills to make rational decisions concerning its portfolio. At the same time that field staff was losing experienced talent and staff reductions made, huge additional responsibilities in entirely new areas have been added to their load.

HUD currently has an arsenal of powerful weapons to deal with recalcitrant owners and poor management. It can terminate management contracts and Section 8 payments, issue temporary denials of participation, foreclose on properties, investigate and demand repayment of funds misspent.

HUD has not effectively used these existing tools for the reasons previously listed. In addition, in my experience the staff's lack of real estate knowledge has created within HUD the inability to distinguish between problems caused by lack of capital, weak markets, poor original construction and those caused by poor management or incompetent ownership. HUD tends not to analyze the source of the problems but merely tends to blame the management company for all problems.

Since neither the Executive Branch nor Congress is desirous of increasing HUD's staff, the oversight process needs to be dramatically changed. The Department must minimize its involvement in well-run properties in order to free up staff to work on its troubled portfolio. This can be accomplished by having each Field Office evaluate their portfolio and divide it into categories. Projects would be rated as well managed if they were fiscally and physically sound, without any regulatory violations and resident problems. The other categories would be projects that have problems but don't require significant oversight, and lastly, projects that the staff should concentrate their energy on.

I suggest that projects in the first category that have been owned and managed by the same companies for the last three years would be freed from most HUD oversight. This would mean, for example, that project requests for Replacement Reserve reimbursements and rent increases below a percentage established by the Secretary and didn't have any substantive resident objections would be automatically approved. Untold hours of staff time are devoted to superfluous procedures that could be delegated to responsible management companies who would be held accountable for compliance with regulations.

If 80% of a management company's portfolio in an Area Office was in this category, then any new management contracts this company enters into would not require HUD approval as long as the fee was within HUD's guidelines.

These suggestions should result in more staff time to devote to important issues.

Owners who are forced to change management companies because of poor performance could only hire companies that were in this decontrolled category. These owners would not be allowed to receive any compensation from the new management company's fees or dismiss the new company without HUD's prior approval.

If this system was implemented over a period of years, HUD could eliminate the incompetent managers and thus reduce its problems to properties that either are failing because they require massive infusion of capital, or the property is truly not viable and probably should be demolished.

B. ESTABLISHMENT OF EXECUTIVE MANAGEMENT TEAM

Even with the realignment of personnel, HUD staff do not have the technical skills, breadth of knowledge or experience to service the most troubled of properties. Therefore, HUD should assemble a team of experts who are accountable to the Deputy Assistant Secretary's office who will be assigned the most troubled properties nationwide.

Team leaders will have authority to make all decisions regarding the formulation of plans for the properties in their portfolio. The team will have supervisory control over a select number of out-stationed HUD staff. They will have special allocations of Section 8 LMSA, Flexible Subsidy and other management tools at their disposal. They will also be authorized to engage technical specialists (i.e., appraisers, tax experts, attorneys, architects, engineers) to assist in the formulation of their plans.

Mr. PETERSON. Thank you very much. The staff tells me that your written testimony was excellent, and if you want to amend it—

Mr. FORD. Thank you.

Mr. PETERSON [continuing]. We will be more than willing to accept it.

Now, your building is right next to Mr. Orehek's building, Edgewood Terrace, is that correct?

Mr. FORD. One of our buildings is next to that building.

Mr. PETERSON. Mr. Shays has to leave. Would you like to ask questions?

Mr. SHAYS. Just very quickly.

The one problem I don't understand to start with, first Mr. Jackson, I have to leave and I would love you to come by my office. I will be in my office a little later, so when we are done if you would come up. My assistant is right here, Chris Allred. I am not going to be asking you any questions, but I appreciate your testimony.

I don't understand why HUD is responsible for paying more than the market rent, and let me ask any of you, should we be paying more than the market rent for any housing, Mr. Orehek? I want a short answer.

Mr. OREHEK. I think that the short answer is a question; are we running a real estate project or is this a small community of very concentrated problems? If you are going to do what Mr. Ford is suggesting he is doing, which I know is a fact, that he is offering social services onsite, too, then he is not just running a real estate project.

Mr. SHAYS. I am just talking about rental property. Mr. Graham, should we be paying more than the market rent?

Dr. GRAHAM. No, but my project is not getting the market rent.

Mr. SHAYS. Then you have an alternative. It is a wonderful alternative. You go out into the market, you just say, I don't like your deal. I am going to go into the marketplace because I can do better.

Dr. GRAHAM. Let me explain it.

Mr. SHAYS. If you can't do better—let me just make this point, if you can't do better, then we are paying the market rent.

Dr. GRAHAM. Well, for that type of a building, see you have got to look at the building and its expenses. This building could be sitting right down in a swank neighborhood on North Michigan Avenue. I have the same two elevators that they may have, I have the same basic tax base and everything, you have to charge what the average building of that capacity is getting. That is basically what is occurring.

Mr. SHAYS. So you are not talking about the market rent then, you want something based on what you want as a return.

Dr. GRAHAM. No, not return.

Mr. SHAYS. It has nothing to do with the relationship of a neighborhood and so on. People next door who rent out space have to rent at the market value.

Dr. GRAHAM. You are missing the point.

Mr. SHAYS. I think I know the point.

Dr. GRAHAM. If you can drive a Cadillac in a poor neighborhood, you can drive it in a rich neighborhood. The expenses are exactly

the same, OK? That is all I am trying to say. This building has basic expenses for that type of a building.

Mr. SHAYS. Your operating expenses may be the same.

Dr. GRAHAM. That is what I am talking about and in order to meet the operating expenses, you have to get the rent, and this rent is not meeting it. Furthermore, the average rent, according in Chicago was much higher than this, the going rate which is the market rate. This is under, to answer your question, this is under the market rent.

Mr. SHAYS. It is under the market rent in some parts of Chicago, but it is clearly over the market rent where your apartment is.

Dr. GRAHAM. Let me say one thing so you get an idea what is going on. No. 1, this building is in an area that is one of the worst in Chicago. In other words, shootings, gangs, and dope. You are not going to get people to walk in there and rent that in there. You are not going to get it. It is my understanding, I thought that their basic idea was to provide housing for people in certain areas.

Now, you will never get anyone to walk in there and spend that kind of money when they can go somewhere else and get it.

Mr. SHAYS. Dr. Graham, I believe you, but I am just trying to establish something. What you are asking for is that they pay you more than the market rent for your area. We may agree or disagree on that, but that is what you are asking for.

Dr. GRAHAM. The way you are putting it.

Mr. SHAYS. I am not putting it any other way than as a landlord, as someone who is a renter. The whole concept was that a renter could go in and make an agreement for a price, and there was an agreement between buyer and seller. If you don't like the deal, just say no to the deal, and if you don't like the deal, then rent it to someone else and get whatever you think the market will bear. That is the concept, and it strikes me that we have gone way beyond that.

Dr. GRAHAM. That wasn't the concept I understood at all because, No. 1, it was for low income, anybody could not come in there for rent. That is not the concept at all.

Mr. SHAYS. Then market rate rent is a meaningless term as far as you are concerned.

Dr. GRAHAM. The whole concept for the project the way you are putting it wouldn't make sense. If you put that building over there and said OK we are not going to rent to people who cannot afford it, we are going to rent to the ones who can afford it and pay market rent, that building, you wouldn't have 10 percent of that building occupied, and that is being real, and in order to look at anything you have to be realistic about it. What you are saying is theoretical and not real.

Mr. SHAYS. Dr. Graham, I don't know what you paid for your building when you got it. I don't know what is the basis of \$1 million mortgage. I don't know if you paid over the price or under the price, but if I take my simple logic and say, can I just offhand ask you what is the percent of your mortgage to the price you paid on the facility?

Mr. OREHEK. I don't remember.

Mr. SHAYS. That is not acceptable, that is not acceptable. How long have you owned this building?

Mr. OREHEK. Since 1983.

Mr. SHAYS. OK, 1983. What did you buy the building for?

Dr. Graham, I would like to know the same question from you in a second, too.

Mr. OREHEK. We believe \$8,700,000.

Mr. SHAYS. You paid \$8,700,000 for it in 1983?

Mr. OREHEK. Correct.

Mr. SHAYS. How much have you taken out of the building?

Mr. OREHEK. We have invested over a negative million five in cash.

Mr. SHAYS. Over the course of how long?

Mr. OREHEK. We put in a million five which we will not recover.

Mr. SHAYS. How much have you taken out of the building, sir?

I want to say something to you.

Mr. OREHEK. We haven't taken out any money.

Mr. SHAYS. I want to say something to you. You are under oath and since 1983 you have taken nothing out of the building, is that your under-oath statement?

Mr. OREHEK. That is the under-oath statement.

Mr. SHAYS. OK. Have you had any tax credits for this building?

Have you used it in any way for any tax writeoffs?

Mr. OREHEK. Certainly.

Mr. SHAYS. OK. What kind of tax credits have you taken?

Mr. OREHEK. There were no tax credits. They were tax writeoffs.

Mr. SHAYS. OK, how much tax writeoffs have you taken for the building?

Mr. OREHEK. The writeoffs—

Mr. LEE. The writeoffs are not cash out of the building.

Mr. OREHEK. Under oath, I am giving you an estimate of \$8,700,000 is our guess, and this amount will be recaptured upon foreclosure or sale of the property.

Mr. SHAYS. Were you given any tax credits, any special tax credits for this property other than general depreciation?

Mr. OREHEK. No.

Mr. SHAYS. Will we be having more hearings?

Mr. PETERSON. Yes, we will.

Mr. SHAYS. Thank you.

Dr. GRAHAM. Could I say one thing?

Mr. PETERSON. Yes.

Dr. GRAHAM. It is not fair for you to question us like this when we are being compared with other properties. That is the thrust I got of this meeting, and if they are being given X number of dollars for rent and they look very well for you to compare us saying how can we look so bad compared to these other properties when they are getting more money, so that is not fair for you to say just individualize and say what did you get. Why don't you go out to the market rate because that is not applying to these other problems.

Mr. SHAYS. I can give you the same invitation as Mr. Jackson. I would love to have you come up and continue this conversation, but I don't think it is fair for the U.S. Government to make agreements with people who can't maintain a building, and if you don't like the agreement, you have an obligation, and my understanding is that even vacant property you get rent from. If it is vacant you still get—

Dr. GRAHAM. No, I do not get rent from vacant property, that is not true. You misunderstood that.

Mr. SHAYS. Property that is not well-maintained you are still getting income from. I happen to think that is not right. You and I disagree on that, but my general feeling is if you don't like the deal the government arranges with you, then don't take the deal. That is my general attitude, but I would be happy in my office later today to continue this dialog if you would like, and I truly regret that I can't be here longer.

Mr. PETERSON. Thank you, Mr. Shays. I have got a few more questions.

I am going to go back to these two buildings that are next to each other. Is yours the same configuration as theirs?

Mr. FORD. No. At the time Edgewood I was built, it was HUD's policy to encourage the development of large units, three and four-bedroom units. It is probable that the subsidy allocation or the allocation of BMIR funds would not have been made to the property had that not been the case.

There is also something that hasn't been said here that I think affects the ability to control this area or property. Part of their low-rise structures involve larger units, three and four-bedroom units. There was also built at the same time in a turn key for the public housing about 70 or 80 public housing units contiguous which is managed by the public housing people, and that is bad news and makes it very difficult to control the things.

Mr. PETERSON. And that is next to their property?

Mr. FORD. That is correct. It is in the same square as ours.

Mr. PETERSON. You are on 6 acres?

Mr. OREHEK. Yes.

Mr. PETERSON. So it is spread out all over the place? Yours isn't that big?

Mr. FORD. It was originally about a 10-acre tract, 9 or 10 acres, and this property is built right there in it of ours. It was built later.

Mr. PETERSON. In my experience with this, in smaller communities, when you have problem properties, the problems seem to overlap and affect the properties nearby. My question is how have you been able to not have these public housing problems go over into your unit? Have you got some secret silver bullet here?

Mr. FORD. It is like anything else. It is not one thing. Part of it is the high-rise structure, it can be secured better.

Mr. PETERSON. You have a high rise, is that correct?

Mr. FORD. That is correct. It was built under Mr. Romney's breakthrough. It can be secured easier, that is part of it. Part of it is that we have owned it right from the beginning and have had the opportunity to continue to do the type of screening that we do of tenants, the type of controls that have been subjected for a long time to our own disciplines from the beginning, and so I think those are two possible reasons.

Mr. PETERSON. You took this over after it had been around for 10, 15 years?

Mr. OREHEK. I believe 12 years.

Mr. PETERSON. And were there problems when you took it over?

Mr. FORD. I probably know more about that than he does.

Mr. OREHEK. Gene.

Mr. FORD. Yes, there were. I built that property.

Mr. PETERSON. Did you sell it to them?

Mr. FORD. That is correct, and I sold it to them because of some other things, these things compound, but basically a lot of problems with reserves deriving out of the type of underwriting FHA was doing in the late 1960's and the subsequent inflation that took place in Vietnam.

Most of the assisted projects by the late 1980's had found themselves woefully short of adequate reserves to take care of what were then replacement problems. I sold this property to them because it was a way to raise money to put in the property to fix it, and that is why I did it. They passed the ACRS. There was tax credits to be gotten, there was syndicators of tax credits and we sold it to them and some of the money went in to fix the property at the time.

Mr. PETERSON. Were there rehabilitation credits involved in this?

Mr. OREHEK. No, the money went directly in, but there were no credits.

Mr. PETERSON. It was a straight tax shelter?

Mr. OREHEK. Right, deductions.

Mr. PETERSON. And you syndicated it?

Mr. OREHEK. Correct.

Mr. PETERSON. You said that as you needed money you got more investors? Did you do that between 1983 and 1986?

Mr. OREHEK. In this particular project I don't believe we did. In other projects—

Mr. PETERSON. But after 1986?

Mr. OREHEK. After 1986 that was no longer an opportunity.

Mr. PETERSON. Who are Edgewood Associates?

Mr. OREHEK. It is a limited partnership.

Mr. PETERSON. We don't know who they are?

Mr. OREHEK. It is—I think you have—

Mr. PETERSON. I have the chart, but you are way down here under SP Continental.

Mr. OREHEK. I believe Edgewood—

Mr. PETERSON. There are all these other layers in between. You are not one of the Edgewood Associates?

Mr. OREHEK. Edgewood Associates has a general partner called SP 82, which has a general partner of which I am a general partner, and then the other partners would be a limited partnership.

Mr. PETERSON. Is that public information, who those limited partners are?

Mr. LEE. Yes, it is on file with HUD and with the District of Columbia Government, Department of Records.

Mr. PETERSON. Did you put in substantial equity at the time you got into this?

Mr. OREHEK. The partnership put in over \$300,000 to rehabilitate the project when it was purchased.

Mr. PETERSON. You had to put money in to rehabilitate it?

Mr. OREHEK. Pay money to the seller and put money into the rehabilitation.

Mr. PETERSON. I am sure that your partners after 1986 were wishing that they never would have bought it, right?

Mr. OREHEK. There haven't been a lot of benefits since 1986.

Mr. PETERSON. I suppose that they became passive losses in 1986, then they couldn't use them?

Mr. OREHEK. Correct, they were phased out.

Mr. PETERSON. Dr. Graham, according to this, your rents are up to \$849 a month?

Dr. GRAHAM. Yes, and that is not even as high as some of the areas, the buildings in my area are getting, and so——

Mr. PETERSON. These numbers you gave us were what they were before they gave you this increase?

Dr. GRAHAM. As late as March, and this has been going on for about 5 years. I have basically been losing all this money.

Mr. PETERSON. Right, now that they have given you an increase, you have to put this in the building?

Dr. GRAHAM. Which means, I would think, that the increase would be for me to run the building. They want me to rehabilitate it, too, which means that wouldn't be enough money.

Mr. PETERSON. Are you not going to do that?

Dr. GRAHAM. No, I am just making a statement, I will do what I have to do with what I have, but I just want to explain, you know, the situation.

Mr. PETERSON. What were the rents when you first built this?

Dr. GRAHAM. I can't remember. It was about \$200 something back in 1971 when it started.

Mr. PETERSON. Were there subsidies?

Dr. GRAHAM. No. See, I had a problem. I had no subsidies. I really got a beating when it first came in. Then when they started the subsidies, they had a gatro law. I don't know if I am pronouncing it right, where there had to be a certain racial makeup, so one-third of the building they wouldn't subsidize and that went on for a long time and then about 10 years, 11 years ago is when I got a subsidy, and I put a lot of my money into it, I didn't mention that, too. I almost foreclosed and I had to come up with \$35,000, and I have been throwing money in that all along. I didn't take management fees for about 9, 10, 11 years.

Mr. PETERSON. Do you know how much money you have got stuck in this?

Dr. GRAHAM. It is a lot of money, over \$100,000 very easily.

Mr. PETERSON. When you first built this you had to put equity into it?

Dr. GRAHAM. Well, yeah, I had to get 10 percent equity in there to get it built.

Mr. PETERSON. You got involved in this because you had a HUD-insured loan, correct?

Dr. GRAHAM. Yes. I had a real estate friend, and he told me this was something to go to.

Mr. PETERSON. You were going to foreclose or you couldn't make the payments so HUD gave you some Section 8 to keep you going?

Dr. GRAHAM. I had to come up with, either \$35,000 or \$40,000, and that is when they did and that is what I had to do, and as I explained to you, it shows that this thing was taken over by the government because of a mistake that was made by the local tax authorities where they sent me a bill for \$110,000, and the

Weyerhaeuser Mortgage, a mortgage company paid it, and that threw me behind.

Mr. PETERSON. So that got you in—

Dr. GRAHAM. So all this is something—

Mr. PETERSON. HUD didn't help you with that at all?

Dr. GRAHAM. No, they didn't help me at all. They were ready—it was a group. I am not going to make a statement because I don't want to get anybody to sue me, but I got the impression it was a plot to get my property, because the tenants that showed up, all of this happened right at the 20-year mark when the property could be sold.

I never heard anything from anybody else prior to that, and all of a sudden they were demonstrating, passing out pamphlets saying they could own the building. I think they were thinking in terms of this whole program under Jack Kemp. I don't know what it was, and they were trying, but really I think it was some developers around behind them trying to do this, so—and now they hired the Legal Assistance Foundation. I am involved in a lawsuit.

Mr. PETERSON. Now, you don't own this place anymore or you don't manage it?

Mr. OREHEK. There is a mortgagee in possession in place with HUD. They are in possession and they have a contract manager managing.

Mr. PETERSON. So somebody else has taken over?

Mr. OREHEK. Correct.

Mr. PETERSON. Are they having any better luck?

Mr. OREHEK. We have—under the agreement, it is my understanding that we are strangers to the project, if you will, and we have not been getting updates to know what the project—

Mr. PETERSON. You are the general partner and they don't tell you what is going on?

Mr. OREHEK. Correct.

Mr. PETERSON. Why do you let them get by with that?

Mr. LEE. That was the agreement with HUD when we allowed them to take the property over.

Mr. PETERSON. So you can't know what is going on?

Mr. LEE. Well, we have inquired as to what is going on, and the information has not reached us yet.

Mr. PETERSON. Our information is that HUD is going to put \$10 million into this.

Mr. OREHEK. I did not understand the question.

Mr. PETERSON. That HUD might put \$10 million into this.

Mr. OREHEK. I think we estimated that that might be one of the numbers of what it would take to rehabilitate it, but we don't have any indication of whether they are going to put that in.

Mr. LEE. That is correct. In, I believe it was 1989, we put in a 241 loan application for a \$10 million loan at that point in time. That loan application was denied.

Mr. PETERSON. So are you in danger of losing this?

Mr. LEE. Yes. It will either be foreclosed or we will offer a deed in lieu of foreclosure. There is one other option, and that may be a nonprofit sale which would commit us to selling the property for \$1.

Mr. PETERSON. Mr. Ford, what do you think about this new management company?

Mr. FORD. What do you mean? The one that is in there now?

Mr. PETERSON. Does the management company know what is going on or you don't know anything about them?

Mr. FORD. I don't know that. I have no opinion. I don't really know. I think that they are housekeeping for HUD, in fact, at the moment. I don't think there is any initiatives going on other than safety initiatives. I would be surprised if there would. I mean the worst landlord in the country is HUD, so I assume that there is nothing going on there.

Mr. PETERSON. Mr. Jackson, I guess you would concur with that statement that the worst landlord in the country is HUD? You haven't seen them since 1986, you said?

Mr. JACKSON. The officials in HUD of Jacksonville intentionally ignore the problems there.

Mr. PETERSON. Could you repeat that please?

Mr. JACKSON. They intentionally ignore the problems there.

Mr. PETERSON. Why do you say intentionally?

Mr. JACKSON. Because they don't want to face the responsibility of what they have allowed to get out of control.

Mr. PETERSON. Do you have direct experience with that? Have you talked to them?

Mr. JACKSON. Yes. For example, when, is it Carolyn Boston? She is the loan person in Jacksonville. She came down to inspect, and what I was finding them doing is they were taking her to all of the apartments that seemed to have the least defects. So I met with her and let her know that the people wanted her to see their apartments. So we went back through and she saw the holes in the walls, and this was even before it hit the media, OK. She saw the holes, she saw the rats, she saw the wires hanging out, she saw all of this. But yet there is this "it is not a big deal" attitude by the officials in HUD.

Mr. PETERSON. By the HUD officials in Jacksonville?

Mr. JACKSON. Yes.

Mr. PETERSON. What has happened since the GAO investigation and you have all this media attention, has anything changed?

Mr. JACKSON. No.

Mr. PETERSON. Nothing has changed so far?

Mr. JACKSON. No. I don't understand how Mr. Retsinas can come and say things have turned around. That means he had to talk to Mr. Chaplin and that means he had to talk to people that are under him. Now, after really going out there and looking at what it actually is you have to see that that is not the case. You know, to me personally, I believe, people are trying to minimize this whole situation in order to cover up what it actually is.

Mr. PETERSON. Do you think that they changed the management companies?

Mr. JACKSON. They changed the management company, but the practices continue.

Mr. PETERSON. They did, but it didn't do anything?

Mr. JACKSON. Changed the management but the practices continued. You see, there is this mind set there that HUD is up for the pickings, and so they know that HUD is not really going to enforce

anything, so things can really continue to flow. They can change management, after management, after management, but if they are not going after the owners, which are the real problem, nothing is going to change.

Mr. BERNOLD. In my many jobs as noted, I worked for HUD. I was director of a housing office, and part of the problem is you have a vicious cycle that goes on with HUD. HUD doesn't have adequate staff to monitor the properties, therefore by the time it gets involved with the property, it is usually beyond a management problem.

When you talk about Edgewood I, is the current management company doing anything, no management company can solve the problems at Edgewood I. You are talking about a massive transfusion of capital, and that is a decision HUD has to make.

Mr. PETERSON. Can I stop you right there? I have had some experience with this. It is my impression that once a unit or a complex gets to that position, that even if you go in and get it totally renovated that there becomes kind of a psychology or a reputation which is very hard to change unless you literally throw everybody out and have a whole new concept and a whole new regime. Are you worried about that?

Mr. BERNOLD. We have turned around numerous complexes that have horrendous reputations after you rehabilitate them first substantially.

Mr. PETERSON. How do you do it?

Mr. BERNOLD. It is all part of the management discipline. I mean, one of the key things is being at HUD, HUD was always driven by production. When I was there the key thing was you have a call, how many units are you producing, the last administration wasn't into production, but they were exactly the opposite. They probably called you, how did you produce a unit, but prior to that HUD was into production, and that was the key element. Therefore you didn't hold up production because you thought maybe the management company wasn't competent.

The part in turning around the complex, you have to look at all the components, and a key component is after you put the bricks and mortar together properly, who is going to run it and do they have the capacity to run this type of complex. When you are turning around the complex, tenant selection is the key. Do they have the capacity to enforce the rules? Do they have the systems to maintain the property? Do they have a track record that they put the capital back when necessary.

Mr. PETERSON. In getting to that third point of yours, the tenant selection, as I understand it, under certain of these programs there are some fairly strict rules about relocation and from what I am told it is quite expensive.

Mr. BERNOLD. The preference rules.

Mr. PETERSON. I was told it could cost \$20,000 a unit to try to relocate these tenants if they know how to work the system. Is that true, that they can basically force you to rent an apartment?

Mr. BERNOLD. I assume there are horror stories about how you could, that the Uniform Relocation Act, and if somebody is truly cognizant of the system, that they could—

Mr. PETERSON. That doesn't happen in practice?

Mr. BERNOLD. Oh, it does. In any governmental program there are always people who have the capacity to exploit the program.

Mr. PETERSON. But in general terms that doesn't happen in your experience?

Mr. BERNOLD. In our experience that hasn't been a problem.

Mr. PETERSON. Let's say you have 100 tenants who are wrecking the place and doing all kinds of harmful things to your building, what do you do? You rehabilitate it. Everybody has to move out, is that what happens?

Mr. BERNOLD. We have done rehabilitations in place. It depends on what the problem is.

Mr. PETERSON. You allow them to stay there and if they don't follow your rules, out they go; is that basically what happens?

Mr. BERNOLD. Yes. In fact, we can tell you a scenario that our reputation is such that all sorts of people who don't follow the rules leave when they hear we are buying the building. They voluntarily exit.

Mr. PETERSON. They go to the other gentleman's place and cause him more problems?

Mr. BERNOLD. They would have to go somewhere. What one of the issues is who houses those highly destructive people who cannot be decently housed, whose problems transcend housing, and my position is not me. I am not a social worker. I don't have the capacity. I set up systems to exclude those types, as best I can, those types of individuals from living in my complexes, and if I find them, I evict them.

Mr. PETERSON. You are like the underwriters in the health care system, figuring out who is going to get sick and get them out of your policy.

Mr. BERNOLD. It is almost exact—one of the big keys in management is tenant selection and enforcement of the rules, and then to have the capacity to use the money that you collect in rents efficiently and plan for the future.

Mr. PETERSON. The thing I hear from other people is that they can't do this because the Legal Aid Society is suing them and because of all these laws that are in place.

Mr. BERNOLD. It has become harder and harder to run a property. I mean, on one hand we have this committee talking about HUD failures. On the other hand, we have Congress passing laws making it virtually impossible for you to manage your property by making it harder and harder for you to select what type of individual lives in your complex.

At the current time HUD is actually—one of the problems you have, if I may digress for a second, is density. At the current time HUD is suing an owner, I don't remember the State, I believe it is Indiana, who had a four-bedroom unit. HUD's own counsel said two people per bedroom is the limit.

Well, now they are suing them because they wouldn't put nine people in a four bedroom unit because we also have a problem of people saying they are trying to solve poverty so the way to solve poverty is to move more and more people into the same unit. However, nobody asks the question, how many more families are we helping. What we are doing is shuffling around the families, so we put in a family of nine whose density, just from the density that

you will create will destroy the complex no matter what the management is or the ownership is or we can put in a family of five or six whose density is suitable for the unit and would not end up destroying the complex. And one time we solved one family's problem, the other time we solve a problem of a family momentarily and then we lose the complex in the long run, so there is all these conflicting issues that are going on.

Mr. FORD. To make a point, I eliminated that part of this conversation here, but there is a fundamental dichotomy here of things. HUD is a mortgage insurer on one hand. HUD is a deliverer of assisted housing on one hand. HUD is a monitor of fair housing on another hand, and what he is talking about are these occupancy rules, the standards in the industry around the world—not around the world, in this country have been like up to two people per bedroom.

HUD's guideline said, yeah, that is an acceptable standard, and administrative law judges and Ms. Achtenberg are suing people all over the country because you are limiting occupancy to two persons to a bedroom, and I will tell you, the point I was going to make, that HUD—there are a lot of projects that HUD has got, some that we have, that we may ultimately have to give back because we are not going to be able to control them when we can't take people with unlimited standards for how many people they can put in a unit. And I will tell you, you cannot manage a property like that, and the bag holder here is going to be the insurance fund. That is a relatively new development, I might add.

Mr. PETERSON. Did you want to say something, Dr. Graham.

Dr. GRAHAM. No.

Mr. PETERSON. Well, I have got some more questions, but we have been here a long time today. I appreciate very much all of you coming and spending some time with us today, and I think you helped, at least helped me understand better what we are up against.

I may use you folks, now that I know who you are, as resource people who might be willing to answer some of our questions. We are going to continue to look at this. But I think your last point here is that one of the things we ought to ask is should we segregate some of these goals into different agencies so we don't have HUD working against each other, probably something that is very relevant to look at.

Mr. BERNOLD. You should ask some people at HUD what it takes to do a policy between the warring factions because of that.

Mr. PETERSON. That is probably one of the reasons why the comparability regulations aren't done after 4½ years. Anybody else have any burning statement they need to make before we wrap this up? If not, we thank you all again for being with us. We will continue this at a later date. The subcommittee is adjourned.

[Whereupon, at 3:05 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]



SECTION 8 HOUSING: WASTE AND MISMANAGEMENT

THURSDAY, OCTOBER 6, 1994

HOUSE OF REPRESENTATIVES,
EMPLOYMENT, HOUSING, AND AVIATION SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 9 a.m., in room 2247, Rayburn House Office Building, Hon. Collin C. Peterson (chairman of the subcommittee) presiding.

Present: Representatives Collin C. Peterson, Bobby L. Rush, Karen L. Thurman, William H. Zeliff, Jr., Christopher Shays, and Frank D. Lucas.

Also present: Wendy D. Adler, staff director; Linda Thompson, professional staff member; June Livingston, clerk; and Judith A. Blanchard, minority deputy staff director, Committee on Government Operations.

Mr. PETERSON. The subcommittee will come to order.

Good morning, everybody. This is the subcommittee's second hearing on problems in HUD's Section 8 project-based housing program. This large Federal program provides over \$4.3 billion annually to more than 20,000 projects across the country. This hearing today will explore why millions of those dollars are being misspent.

Under this program, HUD provides rental subsidies and, often, HUD-insured mortgages to private landlords who must provide decent and safe housing for low-income families. Unlike the Section 8 Voucher Program, these Section 8 project-based subsidies attach to the apartment building rather than to the tenant. So tenants are unable to leave a project when living conditions deteriorate.

Our first hearing revealed widespread serious problems. Subcommittee members viewed a dramatic video by the General Accounting Office of squalid HUD-subsidized apartments. Testimony revealed that HUD has not been adequately inspecting the conditions of its projects. And HUD has not been enforcing its own housing quality standards with these project owners.

HUD at that time could not identify which projects in its inventory across the country were troubled, either financially or physically. The HUD Inspector General estimates that about 30 percent of these properties are in trouble.

Both the HUD IG and the GAO gave HUD at that period an "F" for not enforcing its sanctions. And the HUD IG testified that there is a "culture at HUD that results basically in a wholesale disregard for available enforcement tools."

Today's hearing will focus on possible solutions to these problems. We will look at what HUD should do with the troubled projects in its inventory. While HUD no longer funds the startup of any new projects, it still spends hundreds of millions of dollars annually to subsidize troubled projects. In some cases more money may be justified, but in other cases it may not. But HUD doesn't know if investing more money is the right action for a project. And that is HUD's real problem: You can't devise a solution until you know the extent of the problem.

HUD gives millions of dollars a year to troubled projects, as I said. And the HUD IG will report today that HUD neither collects or analyzes adequate financial information on projects. This information we believe is crucial for making cost-effective decisions on troubled projects.

The IG will testify, in their words, "HUD often attempts to turn troubled projects around by blindly throwing additional financial assistance at them rather than biting the bullet and cutting the Federal Government's losses by taking bold aggressive actions, including actions to enforce or terminate its contracts with owners."

To get a handle on this problem, the subcommittee asked the GAO and the HUD IG to provide financial and cost-benefit analyses of four troubled properties. Their findings today will review the issues that HUD must consider when deciding on remedial action for a troubled project.

I think HUD has taken a good first step by forming the SWAT teams to identify and resolve problems at 100 projects. A more comprehensive solution to HUD's problems is in a bill that I introduced on September 28. That bill would require that HUD determine the best remedial action for a project.

Before HUD pours any more money into a troubled project, HUD would first be required to do a complete financial and cost-benefit analysis. Then HUD would be required to select a remedial action, which would include funds to renovate the property; rent vouchers for tenants to use elsewhere; new project ownership or management; enforcement of sanctions against owners; and, finally, foreclosure. HUD would also have to assess each action's impact on the tenants, owners, and the community.

The bill that I have introduced is one possible solution. We hope to hear from our witnesses today about other approaches.

And hopefully we can move this whole issue in the right direction.

I see our ranking member is here. I would like to welcome our esteemed ranking member, Mr. Zeff from New Hampshire.

Do you have a statement?

Mr. ZELIFF. Thank you Mr. Chairman. I appreciate you calling the subcommittee together again this morning to continue the examination of the troubled Section 8 housing program.

Section 8 is a well-intentioned program which has, in my view, failed miserably in its mission to provide safe and decent housing for low-income Americans. At the last hearing we heard compelling testimony from an individual forced to live in an Section 8 project, and also testimony regarding lack of enforcement of HUD's own standards.

HUD was enable to provide us with a clear understanding of the number of below-standard Section 8 projects across the country.

I said it then, Mr. Chairman, I will say it again: We do not need more excuses from the people who administer these programs and the administration itself. We need a results-oriented strategy to solve these problems. We owe it to the people living in project-based housing as well as the taxpayers who pay the tab to reform this flawed program.

I salute our efforts toward this end, Mr. Chairman. I believe that the legislation you have introduced takes a needed step in the right direction.

However, I question whether this is a system that can be fixed. Is the solution to this problem to try to fix a program that is by many accounts fatally flawed? How much longer shall we confine individuals to substandard Section 8 projects when quality housing units might be available nearby?

In my view, we should seriously consider scrapping the project-based approach altogether and explore voucher-based programs to provide low-income housing to Americans.

I look forward to hearing testimony from our witnesses.

Thank you, Mr. Chairman.

Mr. PETERSON. Thank you.

Mr. Lucas, welcome to the committee.

Susan Gaffney, the Inspector General of the Department of Housing and Urban Development, accompanied by Chris Greer, Assistant Inspector General for Audit with the IG.

Ms. Judy England-Joseph, Director of the Housing and Community Issues Area with the General Accounting Office, accompanied by Dennis Fricke, Assistant Director, Housing and Community Development Issues.

Nicolas Retsinas, Assistant Secretary for Housing, Federal Housing Commissioner with HUD, who is accompanied by Helen Dunlap, Deputy Assistant Secretary for Multifamily Housing.

Welcome to all of you. We appreciate your work and coming back before the committee.

As you know, it is our custom in Government Operations investigative hearings to swear in all witnesses. Do any of have you any problem with that? If not, please stand and raise your right hand.

[Witnesses sworn.]

Mr. PETERSON. Your written statements will all be entered in the record.

I would like to warn everybody we have to be done at 11 a.m. because of the address by Mr. Mandela. It seems like every time that this subcommittee has a hearing, some major thing happens. I don't know what that means.

Mr. ZELIFF. That means we are doing major things.

Mr. PETERSON. With that, Ms. Gaffney, you may begin. Thank you for your work and thank you for being with us.

**STATEMENT OF SUSAN M. GAFFNEY, INSPECTOR GENERAL,
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT,
ACCOMPANIED BY CHRIS GREER, ASSISTANT INSPECTOR
GENERAL FOR AUDIT**

Ms. GAFFNEY. Thank you, Mr. Chairman and members of the subcommittee.

I would like to take one second and introduce some people who are here with Chris Greer and me today. They are in the second row: George Tilley, Jerry Hite and Ron Jilg, from our Seattle office, who actually did the financial analyses that you requested on the two projects.

And I want to commend your attention to and concern about this issue, and just stand back for a minute and remember why this concern is so warranted. Our office believes that the multifamily programs in HUD are in a state of crisis. It is a crisis that has been brought about by changes in the economy, budget considerations, policy deficiencies and mismanagement, over quite a long period of time.

Unfortunately, despite all of the indications that we have a crisis, there doesn't seem to be much discussion outside this subcommittee. But the indicators of the crisis are clear. First of all, we are investing billions of dollars a year in project-based Section 8 and we are not sure about the quality of housing that we are getting as a result of that investment.

Further, this program works through the private sector, but it lacks any of the normal private-sector inducements and incentives that bring about efficient and effective management of housing.

In 1993, you will remember FHA paid almost \$1 billion in multifamily insurance claims. They also had losses of more than \$367 million on previously foreclosed projects.

Currently, the loan-loss reserves, that is, the projects that are at risk in the portfolio, are in excess of \$10.3 billion. That is a quarter of the multifamily loan portfolio.

And finally, and perhaps most importantly for our consideration today, within the next few years some 600,000 units covered by Section 8 project-based contracts are going to come up for renewal, which presents us with a situation of enormous opportunity and also enormous risk.

Against this background it seems to me that these hearings are incredibly important. And H.R. 5115 is certainly a move in the right direction. I commend you.

Now, I am going to briefly try to answer the questions that you asked us to answer. First of all, you asked whether HUD was performing the types of comprehensive financial analyses that are called for in H.R. 5115, whether HUD has the relevant information it needs, whether HUD is exploring fully the alternatives about how to deal with these troubled properties, and whether HUD is taking effective action. So we need to start with the first point, whether HUD has all the relevant information it needs to deal with these troubled projects, and the answer is clearly: No, HUD does not have all that information.

HUD has a lot of information. It is collected on a piecemeal basis. It is not all current. It is not all consistent. And it certainly is not comprehensive.

I want to take a minute, though, and say that we have testified before you before, and in other places, and we have attributed this situation to systemic problems in HUD. The systemic problems are real. There is a lack of staff capability. There is a lack of decent data systems. There is a lack of adequate management controls.

And we have said for some years, those things need to be fixed. And they do need to be fixed. But we can't wait for them to be fixed, which I think is the point Mr. Zeliff was getting to. Nic Retsinas and Helen Dunlap have initiated a lot of actions to solve the systemic problems.

In our judgment, those solutions are years in the future. We have to figure out some way to deal with the crisis that is before us right now.

In terms of using what information HUD has about these projects to deal effectively with the projects, our view is generally that HUD deals with current problems on a temporary basis without considering fully the long-term effects, the long-term viability of projects.

You also asked second about audits of HUD's use of current financial tools to address troubled projects. And we have done some work in this area. In 1992, we looked at the loan management set-aside program. We found errors, inconsistencies, and omissions in 29 percent of the applications that we reviewed. We questioned \$10 million in awards made under this program.

In terms of the flexible subsidy program, in 1983 and 1989, we said there were major procedural weaknesses in this program. HUD did not change its procedural guidance until May 1992.

We have looked at other aspects of this program which involve HUD's monitoring of State finance agencies in their administration of flexible subsidy loans and have found inadequacies.

Another way that HUD can address troubled projects is through special rent adjustments. In 1990 we did an audit and found that the process for special rent adjustments was not adequately controlled, that in some cases special rent adjustments were being given for factors already included in the annual adjustment calculation.

We found that HUD lacked adequate controls and documentation to identify, account for the rent adjustments, and then to follow up to see whether in fact the rent adjustments are needed in subsequent periods.

The bottom line from our perspective is that HUD has not been very good in using these tools. That is not really surprising, given the basic lack of comprehensive knowledge that HUD has about the projects. It is also true that these tools are very, very limited, which I want to talk about later.

Third, you asked us to perform financial analyses of two Section 8 projects: Holiday Lake Apartments in Pompano Beach, FL, and Sierra Nevada Arms in Las Vegas. In collaboration with the General Accounting Office, we used a consistent approach to doing these financial analyses and essentially what we did was compare the costs of providing all of the tenants with tenant-based Section 8 vouchers with the cost of rehabilitating these projects with borrowed funds and providing Section 8 project-based assistance to all of the units in the rehabilitated projects.

Our findings were that at Holiday Lake, assuming the HUD projected rehabilitation costs, the rehabilitation option would be less expensive by about \$1 million than the tenant-based voucher option.

That calculation changes, though, depending on the cost of the rehabilitation. If the rehabilitation costs in fact were \$2.66 million or more, as opposed to the HUD estimate of \$1.33, the tenant-based vouchers would become less expensive.

Incidentally, at Holiday Lake, 20 of the 32 tenants we interviewed said if they could move, they would move.

At Sierra Nevada Arms, we had the same kind of finding, which is, assuming the HUD costs of rehabilitation, the rehabilitation would be approximately \$2 million less expensive than providing tenant-based vouchers. Again, that calculation changes if the rehabilitation costs are \$5.9 million or more.

But I think the most important thing we learned, Mr. Chairman, was not those specifics. What we learned was that first of all, these calculations are all case by case. Each one of these projects has a peculiar mix of factors. The analysis has to be done intensively and based on an individual project and it is complicated. And what we did is certainly not the full range of what needs to be done because we were focusing on financial factors as opposed to all of the other for instance, social factors that need to be considered.

It is very clear that HUD needs not only to do these kinds of analyses but HUD needs the flexibility once you do the analyses to act appropriately with prudent business sense.

You asked next whether we had recommendations on how HUD can make the most cost-effective decisions on troubled projects. We have recommendations in that area. We would say to you we also need to be very concerned about ways to prevent projects from becoming troubled, because obviously that continues to happen.

The first step is, HUD has to identify its universe, it has to conduct the kind of analysis that you are calling for in H.R. 5115. We have to establish some capability for HUD to act.

I want to go back to what I said before. HUD doesn't have the capability. And I don't see that HUD is going to get the staffing resources it needs to deal with these problems. I think training the existing HUD staff is going to take years. So we have to look for innovative ways to establish a capability that is not dependent on the number of HUD FTE.

Next, we have a series of proposed legislative changes that are included in our written testimony. I am not going to go through them all here now. I would like to say, though, I don't think that we, the HUD OIG, have all the answers.

It is clear that the way this program is working, the way it is now designed, is not consistent with prudent, businesslike operations; that it seems to be premised in a distrust of HUD's ability to act prudently; and it seems to be based further in a conviction that we must maintain this inventory of affordable housing as opposed to maintaining a stock of affordable housing. The focus in this program seems to be on this stock of affordable housing, owned by this group of owners. And I think we must be able to move away from that, and if we can't, I really do not see how HUD can act to correct these problems.

All of this is very important particularly because of these contract renewals that are coming up in the next few years. To my knowledge, but you should ask Mr. Retsinas, HUD does not now have a comprehensive plan of action for dealing with these contract renewals. That prospect of contract renewals is both opportunity and enormous risk.

Finally, I would like to just bring to your attention an example of what we consider to be the flawed program design in this area. And this is not a topic for discussion, I know, today. It is a matter of great concern to us. It is the multifamily prepayment and preservation program.

This is a program that was enacted in 1987, and it was enacted because of particular market situations in California and Massachusetts. There was a great fear that what was going to happen was that owners of these multifamily projects were going to prepay their loans and thereby we would lose those units of affordable housing.

In order to prevent this from happening, we have a law that essentially locks HUD into providing enormous financial benefits to owners who come to us and say they want to exercise those benefits at their discretion.

At the discretion of the owners, HUD is providing equity take-out loans and increased distributions, and then the way the owner is compensated is through higher rents and greater Section 8 subsidies.

Part of the problem with this is not just the enormous cost, which we estimate at \$37 billion—

Mr. SHAYS. Million?

Ms. GAFFNEY. Billion—to the taxpayer. Part of what is wrong with this scenario is as the rents are increased, they are increased not only for the Section 8 units, but for the unassisted units too.

They can be increased by three times as the result of one of these deals. What that means is we drive out tenants who are unassisted, who are not getting the Section 8 subsidy.

So I bring this to your attention just because it is one example of how constrained HUD is to do things that don't seem to make a whole lot of sense.

Thank you.

[The prepared statement of Ms. Gaffney follows:]

STATEMENT OF
SUSAN GAFFNEY, INSPECTOR GENERAL
ACCOMPANIED BY
CHRIS GREER, ASSISTANT INSPECTOR GENERAL FOR AUDIT
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BEFORE THE
SUBCOMMITTEE ON EMPLOYMENT, HOUSING AND AVIATION
OF THE
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

OCTOBER 6, 1994

Chairman Peterson, and members of the Subcommittee, we are pleased to be here today to further examine problems in HUD's Section 8 project-based assisted housing programs. At your request, our testimony this morning will focus on four areas: 1) the concept of financial analysis leading to decisions about possible alternatives for dealing with troubled projects and HUD's use of such analyses, 2) the effectiveness of HUD's use of various financial tools to assist troubled projects such as Loan Management Set-Aside, Flexible Subsidy Loans and special rent increases, 3) our financial analyses of two troubled projects, Holiday Lakes and Sierra Nevada Arms, and 4) our recommendations for dealing with troubled projects on both a short term and long term basis.

Mr. Chairman, before we begin our testimony on your specific requests, I want to state emphatically that HUD's multifamily project based assisted housing programs are in a state of crisis. As a matter of fact, I would liken the current situation in many respects to the savings and loan debacle. Numerous reports by our office, by GAO and by third parties clearly demonstrate that HUD needs to develop a coherent and comprehensive plan for dealing with troubled projects. Much work remains to be done in that regard. In addition, Congress, OMB and HUD need to collectively develop a strategy to deal with the multifamily crisis. Some of the factors leading to our conclusions are:

For several years our Office has reported to Secretaries Kemp and Cisneros, and to the Congress and OMB, that Multifamily Loan Servicing and Property Disposition are among HUD's major programmatic problems. Systemic management weaknesses associated with staffing shortages, inadequate data systems, and faulty management controls adversely impact everything that HUD does. These weaknesses are particularly evident in HUD's multifamily assisted programs and contribute to the following financial facts: 1) last fiscal year FHA paid over \$965 million in multifamily insurance claims and realized losses of over \$357 million on previously foreclosed projects, 2) at September 30, 1993, HUD established a loss reserve of

about \$10.5 billion on outstanding loans of \$43.9 billion, i.e. about 24 percent of all loans are at risk, and 3) HUD holds mortgages on about \$7.8 billion for which claims were previously paid. About \$6 billion of those mortgages are non-performing loans.

In April 1994, our Office of Audit issued a report that was very critical of the Prepayment/Preservation program. I was so disturbed by the results of that study that I personally transmitted the report to all appropriate Congressional committees with jurisdiction over HUD programs. In transmitting that report I called the program an emerging scandal that will cost the taxpayers billions of dollars. With an estimated 400,000 units eligible for assistance under the program, tens of billions of dollars are at stake.

During the next few years, contracts for an estimated 600,000 units of Section 8 project-based assisted housing will expire. Unless aggressive actions are taken now, many of the problems being reported today will continue and multiply in the future. Our office is launching a review of the contract renewal process to determine possible options for dealing with expiring contracts.

Thus, Mr. Chairman, we believe that the timing and subject matter of this hearing are crucial. A key element in any debate about the future of project based assisted projects must be comprehensive financial analyses that lead to logical conclusions about potential alternatives. In this regard, the bill (HR 5115) that you introduced last week certainly can serve as a catalyst for the needed debate. That debate must also consider the substantial lack of HUD's human resources, in terms of both numbers and expertise, to deal with the myriad problems plaguing the project based assisted projects. Our Office is now convinced that the needed resources will not materialize given the current budget situation governmentwide. Thus alternative programs or delivery systems must be considered in going forward with project based assistance.

Later in our statement we provide several suggested recommendations to significantly change the project based assistance programs. We would expect that many different segments of the assisted housing industry will find our suggestions controversial. Nonetheless, we believe dramatic actions are needed to overcome the numerous problems associated with current conditions of the assisted housing stock.

We would now like to present our input on your specific questions.

FINANCIAL ANALYSES

In your invitation letter you asked our opinions on whether HUD currently performs the types of financial analyses we will be discussing this morning for each of its troubled projects; whether the financial information collected include all relevant

information to make decisions on alternatives to continuing the project based assistance on the project; and the effectiveness of HUD's current processes for using relevant information to take appropriate actions.

HUD does not currently perform an analysis to determine the most advantageous, least cost alternative to providing decent, safe and sanitary affordable housing to tenants living in currently troubled projects.

HUD collects project level information from a variety of sources, such as its comprehensive and limited project management reviews, physical project inspections, tenant file reviews, annual project financial statement reviews, and project financial needs surveys. Most of this information is collected as part of HUD's routine project monitoring processes for the primary purpose of identifying compliance deficiencies and labeling projects according to the perceived extent of their problems, e.g. - "troubled project" status. Aside from the fact that HUD's monitoring information is often not readily available, current, accurate or complete, it generally is not effectively used to initiate aggressive action to remedy identified project performance problems.

In many HUD solutions, the basic conditions which led to troubled status remain the same, but HUD has subsidized temporary relief. For HUD to provide affordable housing that best serves the needs of the tenants and the community, HUD needs to collect and review adequate data on market conditions associated with its troubled projects, such as information on other housing sources, area occupancy/vacancy rates; area market rents; area occupancy profiles by income, family size, race; and location, etc.

The availability of such information would enable HUD to realistically and practically consider and/or pursue: (1) the economic and social implications and impacts of alternative subsidy or financial assistance mechanisms; (2) changes in project ownership or management; and (3) other options such as declaring mortgage covenant or regulatory agreement defaults or imposing /sanctions. This would then enable HUD to reach a rational conclusion as to the impact on existing residents or the community at large of applying or not applying various remedial actions.

In summary, HUD needs to explore a broader range of alternatives for providing affordable housing.

FINANCIAL TOOLS

In your invitation letter you asked us to discuss any recent studies or audits that relate to HUD's effectiveness in using current financial tools that can provide additional assistance to troubled projects, such as Loan Management Set-Aside (LMSA), Flexible Subsidy Loans, or special rent increases. You also asked

that we identify some specific examples of questionable decisions in the award of additional funds to troubled projects.

SECTION 8 LMSA

The clearest examples of waste and abuse of the LMSA program are contained in our March 31, 1989 audit report of Discretionary LMSA funding. That report clearly demonstrated that former HUD officials illegally granted substantial sums of LMSA funding to projects with the resultant waste of millions of dollars. This program was one of many that came under congressional scrutiny during the hearings on the "HUD Scandals." An investigation into this matter resulted in former Assistant Secretary Demery pleading guilty on June 17, 1993 to several criminal counts relating to the award of LMSA in exchange for personal financial benefits. One developer alone received HUD subsidies exceeding \$15 million on two HUD insured projects.

The HUD Reform Act of 1989 changed the LMSA program from discretionary to a nondiscretionary (competitive) funding process. Our most recent experience with the non-discretionary LMSA program is our July 16, 1992, multi-region audit report that disclosed that HUD's Field Offices were not properly processing non-discretionary LMSA applications. We found errors, omissions and inconsistencies in 29 percent of the non-discretionary LMSA applications we tested causing us to question about \$10 million in awarded LMSA assistance. In some cases, we found that projects: (1) received funding for more units than were needed to 'stabilize projects' financial conditions; (2) had serious financial problems that could not be resolved by the additional LMSA assistance; (3) received LMSA assistance even though the projects did not have serious financial problems or otherwise meet the minimum qualifications or priority considerations for funding; (4) charged excessive contract rents; and (5) lacked audited financial statements in support of their assistance requests.

The report contains several specific examples of questionable HUD decisions in awarding LMSA assistance. For instance, we took exception to the LMSA award to the Woods of Castleton project in Indianapolis, Indiana. At the time of our review, HUD had provided this project owner LMSA assistance for 26 units and subsequent to our review an additional 26 units was approved (we did not review that award). We found that the project's cash requirements exceeded its rent potential by over \$151,000. Even at full occupancy, this project would not have been able to meet its cash requirements. Moreover, the project's long-term viability could not be predicted due to the project's extremely high debt service ratio. The HUD Field Office nevertheless approved the LMSA assistance for this project despite the HUD Loan Specialist's belief that the project had problems which could not be addressed by LMSA assistance. LMSA funding for this project may exceed \$522,000 over the five-year life of the LMSA contract. The project

subsequently went into default. It is now under a workout agreement with HUD and is current under that agreement.

FLEXIBLE SUBSIDY

Our review of the Flexible Subsidy program has been limited in recent years. However, prior reviews of this program disclosed that HUD's program guidance was weak in several key areas, resulting in the Department's inability to ensure that program funds were being used effectively to meet the physical and financial needs of projects. We first reported procedural weaknesses in the Flexible Subsidy program as far back as 1983, and again in 1989. However, it was not until May, 1992, that HUD revised its program handbook procedures. Other reviews have disclosed problems with HUD's monitoring of State Housing Finance Agencies' administration of Flexible Subsidy funds. We found that some state agencies: failed to perform proper analyses to determine whether physical and financial problems of projects would be corrected with Flexible Subsidy funds; advanced funds prior to their need; and used funds for ineligible purposes. We found instances where HUD advanced Flexible Subsidy funds to state agencies for almost four years before they were actually used. One state agency earned over \$558,000 in interest income by investing the excess funds.

SPECIAL RENT ADJUSTMENTS

Several years ago, we performed an internal survey of HUD's processing and approval of Section 8 special contract rent adjustments. At the time of our survey, owners could apply to HUD for special contract rent adjustments as a result of "substantial general" increases in their property taxes, utility rates, or similar costs (e.g., insurance). These special rent adjustments have since been expanded to crime-related cost increases and to provide service coordinators. Owners are required to demonstrate that these types of costs are not adequately accommodated by rent adjustments granted by HUD through its Annual Adjustment Factors. Our survey disclosed that HUD was unduly expanding the scope of special rent adjustments to areas that appeared to be covered by the Annual Adjustment Factors. We also found that control records in support of these rent adjustments were inadequate; consequently, HUD was unable to account for all the special rent adjustments it may have granted and adequately follow up with projects to determine if the rent adjustments were still needed by the projects. We further concluded that the processing of Section 8 special rent adjustments was not always in conformity with HUD's established policies and that such processing was highly vulnerable to fraud, waste, and abuse.

In summary, Mr. Chairman, HUD does not have a good track record in administering these financial tools. Moreover, we believe that the tools need to be significantly changed or eliminated in the future.

PREPAYMENT/PRESERVATION ISSUES

At this point we want to express our strong opinions about the Multifamily Prepayment/Preservation program. Although this program is not classified as a financial tool to aid problem projects, the program's objectives are the same. Our audit of activity to date shows that it is not achieving its "affordability" objective without an exorbitant cost to taxpayers and/or undue enrichment of project owners. In April 1994, we issued a major report on the Multifamily Prepayment/Preservation Program. The report concluded that the Preservation Act, while well intentioned, was designed and passed by Congress in 1987 and amended in 1990, as a totally inflexible and enormously costly method of preserving low income housing. The Act was passed based primarily on the housing markets in California and Massachusetts. Since the property values in these two states had significantly appreciated, the fear was that project owners would opt to prepay their mortgages and significantly decrease the supply of low income housing. These fears have not materialized and we believe significant modifications are needed to the legislation now to reflect current not past conditions.

In our report, we estimated that if the legislation were revised to provide HUD with the flexibility to analyze and implement the least cost method of funding long term low income housing, costs could be reduced by tens of billions of dollars below the current inflexible owner-driven program.

The preservation program causes increased costs to HUD by compensating property owners through FHA-insured loans (equity take-out loans) or increased annual distributions. HUD and residents pay for the owners compensation through increased rents that cause higher vacancy rates for unassisted units. Therefore, preservation increases the risk to the FHA insurance fund if HUD rental subsidies do not offset vacancies and unassisted resident rents that are lower than the Section 8 rent.

Some of the cost-saving options that could be explored include:

- Purchasing projects and giving them to housing agencies to manage.
- Allowing owners to prepay and purchase new or existing housing needed to replace units lost to prepayment.
- Constructing replacement housing for units lost to prepayment.
- Allowing owners to prepay and arrange for Section 8 project-based assistance of units in currently unassisted projects to replace units lost to prepayment.

- Allowing owners to prepay and give Section 8 vouchers or certificates to those residents that qualify for rental assistance.
- Providing a grant to rehabilitate the project in exchange for a commitment to remain low income housing for the remaining useful life of the project, if a project has no equity and wants to stay in the program

IMPACT OF TITLE 2 PRESERVATION PROGRAM IN BOSTON

As a follow-up to previous preservation audit work done in the Boston, MA. area, our staff is currently analyzing the actual effect of the program on HUD costs, the tenants, the owners and the community. Our preliminary results are instructive in that they dramatically show the impact of the inflexibility of the laws. Pertinent data relating to two projects under review, follow:

Sherwood Park- is an 81 unit, 221(d)3-BMIR project and rents are subsidized through a lower than market interest rate. The preservation plan of action for Sherwood Park was approved in December 1991. Among the incentives provided to the owner were an equity take-out loan of \$3.8 million and annual Section 8 contract authority of \$344,000 for 30 units of project based Section 8 to support the new debt service requirements resulting from the equity loan. The project is in good physical condition because the owners used \$1.2 million from the equity loan for capital improvements.

The incentives under the preservation program will be very costly and have driven many market rate tenants from the project. Under the interest rate reduction program rents for three bedroom units were about \$357. Under a phased in approach those rents will increase to \$1059 over a three year period. Meanwhile, Section 8 rents are \$1690, or 170% of the Fair Market Rents. Over the long term, in order to avoid a default or project deterioration, HUD will have to either increase the Section 8 rents more or increase the numbers of Section 8 units to keep pace with the increased debt service and the loss of market rate tenants.

Georgetown I and II contain 967 units subsidized under the 221(d)3 BMIR program with 456 units under an existing LMSA Section 8 contract. The preservation plans of action for both projects were approved in September 1992. HUD provided incentives included equity take-out loans of \$36.9 million and additional annual Section 8 contract authority of \$6.3 million for 343 units to support the debt service. Both projects are in good condition. The owners put only \$1.7 million from the loan, back into the project in capital improvements. The balance of the proceeds of the loan was used to pay off the long term debt of the partnerships and pay distributions to the partners.

Like Sherwood Park, the incentives have affected the project

dramatically. Under the rent reduction subsidy, rental rates for three bedroom units were about \$475. Under a phased in approach those rents will increase to about \$995. Meanwhile, Section 8 rents are \$1078 and will have to rise further to offset the loss of market rent and moderate income tenants as they move because of the exorbitant rents caused by the preservation program. Since the Plan of Actions (POAs) was approved a total of 231 tenants (24%) have moved from Georgetowne I & II. For Sherwood Park a total of 37 (46%) tenants moved out. These incentives are very costly and have driven 86% of the moderate and market tenants from Sherwood.

It would be far less costly to provide owners with rehabilitation loans at no cost and eliminate equity take-out loans entirely. We recommend the repeal of Title I and VI preservation legislation.

FINANCIAL ANALYSES---SPECIFIC PROJECTS

In your invitation letter you asked that we provide the findings of our financial analyses of two specific projects that were included in the video presented by the General Accounting Office at the July 26, 1994 hearing.

The two projects reviewed by the OIG are Holiday Lake Apartments in Pompano Beach, Florida and Sierra Nevada Arms in Las Vegas, Nevada.

Holiday Lake Apartments is a 232 unit apartment complex insured under the Section 236 program. The complex currently receives Section 8 project based assistance for 220 units.

Sierra Nevada Arms is a 352 unit apartment complex also insured under the Section 236 program. The complex currently receives Section 8 project-based assistance for 290 units.

Our financial analysis compared the cost of providing Section 8 tenant based vouchers to all residents in the project (Voucher Option), to rehabilitating the project with borrowed funds and providing Section 8 project based assistance to all units in the property to cover the cost of the rehabilitation (Rehab Option). We estimated the cost of these options using comparable market rents for the area and various percentages of the Section 8 fair market rents. All of our calculations below assume Section 8 rents at the projects are set at the level necessary to cover project expenses and rents at units where vouchers are used are equal to comparable market rents.

Specific details concerning our methodology and findings are contained in the appendices to our statement. I would like to summarize those findings for you now.

HOLIDAY LAKE APARTMENTS

For Holiday Lake Apartments our analysis showed that the Rehab

Option is approximately \$1.08 million less expensive than the Voucher option. This estimate used HUD's documented rehabilitation costs of \$1.33 million. However, if rehabilitation costs exceed \$2.66 million then the Voucher option becomes the lower cost option.

In addition to the basic analysis above we calculated the cost of some variations on the Rehab Option without consideration of any restrictions under existing HUD programs. We calculated the costs for:

- a. Paying for the rehabilitation cost up front, and
- b. Improving the tenant mix by limiting the number of units with project based assistance.

If HUD had the ability to pay the rehabilitation costs up front rather than providing Section 8 subsidy to repay the loan, the cost of the Rehab Option is reduced by approximately \$2.9 million. This makes the Rehab Option approximately \$4 million less than the Voucher Option.

To have the project compete in the market place, rely less on HUD assistance, and increase the income mix of the tenants, the number of units with project based assistance could be reduced and replaced with Vouchers. For example, reducing project based assistance to 20 percent of the units and providing vouchers to the remaining tenants would cost \$12.8 million. This is still less expensive than the Voucher Option by \$215,614.

The decisions on factors other than purely financial analysis, such as whether or not to lower project based assistance, are difficult decisions that require additional input on the housing needs of the tenants and surrounding community. During our review 20 of the 32 tenants interviewed said they would move if given the opportunity.

SIERRA NEVADA ARMS

For Sierra Nevada Arms our analysis showed that the Rehab Option is approximately \$1.88 million less expensive than the Voucher Option. This estimate used HUD's documented rehabilitation costs of \$2.66 million. Our calculations show that if rehabilitation costs exceed \$5.90 million then the Voucher Option becomes the lower cost option.

In addition to the basic analysis above we calculated the cost of some variations on the Rehab Option without consideration of any restrictions under existing HUD programs. We calculated the costs for:

- a. Paying for the rehabilitation cost up front, and
- b. Improving the tenant mix by limiting the number of units with project based assistance.

If HUD had the ability to pay the rehabilitation costs up front rather than providing Section 8 subsidy to repay the loan, the cost of the Rehab Option is reduced by approximately \$4 million. This makes the Rehab Option approximately \$5.9 million less than the Voucher Option.

To have the project compete in the market place, rely less on HUD assistance, and increase the income mix of the tenants, the number of units with project based assistance could be reduced and replaced with Vouchers. For example, reducing project based assistance to 20 percent of the units and providing vouchers to the remaining tenants would cost \$17.1 million. This is still less expensive than the Voucher Option by \$377,000.

The decisions on factors other than purely financial analysis, such as whether or not to lower project based assistance, are difficult decisions that require additional input on the housing needs of the tenants and surrounding community.

OIG RECOMMENDATIONS

In your invitation letter you asked that we provide our recommendations on how HUD can make the most cost-effective decisions regarding actions to take on troubled projects. Our office has been reporting to the Secretary and to Congress for years on major systemic weaknesses that effect everything that HUD does. These three weaknesses include the lack of human resources, effective and reliable data systems and sound management control environment. The impact of these deficiencies on Multifamily Housing programs, and especially the troubled assisted housing projects, is enormous. Our Office is now convinced that radical changes need to be made at HUD, not only to address the systemic management weaknesses but also to restructure and rethink how HUD deals with the programmatic problems on both a short and long basis.

Mr. Chairman, I would like to take this opportunity to not only respond to your specific request regarding recommendations to address troubled projects, but I would also like to discuss some of the actions necessary to prevent projects from becoming troubled. If we neglect the latter, we run the risk of fighting an endless battle where new troubled projects replace the old ones. I believe that many actions are necessary and feasible, both short-term and long-term, to restore the viability of HUD's troubled portfolio. For the short-term, perhaps the most logical course of action is to fix the problem as best we can. However, for the long-term, I believe that bolder and more innovative actions are required to restructure HUD's housing insurance and subsidy programs, and the way they are delivered to communities across this Nation. Some of these remedies will require legislative action; others are within the administrative discretion of HUD and need to be taken immediately. With these thoughts in mind, I believe the following

recommendations should be considered by HUD and Congress. Appendix 4 attempts to describe the needed changes graphically.

TROUBLED PROJECTS

A. Administrative Actions

1. HUD should identify the universe of troubled properties and develop profiles showing the financial and operating status of each of its troubled properties. Compilation of this information would enable HUD to make more effective and timely decisions on its troubled portfolio and would facilitate HUD's program enforcement.
2. HUD needs to assess the costs and benefits of the programs they have for helping troubled projects to enable the Department to make informed decisions on what types of assistance to use based on individual projects circumstances.
3. HUD should develop or acquire the capacity and expertise necessary to enable the Department to effectively deal with the problems of troubled projects.

B. LEGISLATIVE ACTIONS

1. Title IV of the Housing and Community Development Act of 1992 requiring owners of subsidized projects to prepare comprehensive needs assessments of their projects should be repealed. We favor more comprehensive legislation similar to that being proposed by the Subcommittee requiring assessment of the physical and financial condition and needs, as well as an analysis of the housing needs of the tenants and community, for each troubled project in HUD's portfolio.
2. HUD should be required to develop a national plan for providing affordable housing through Section 8 project based assistance. This plan should require the Department to use the assessments described above to make decisions regarding the most beneficial method of providing affordable housing that meets the needs of the tenants, the community, and HUD. HUD should have the flexibility to pursue continuing subsidy in the current project only if their analysis shows it is the most preferable form of housing considering both the housing needs in the market and the cost of the subsidy.

HUD should be given the authority and flexibility to discontinue subsidizing all or part of the current project if there is a less expensive viable form of housing available in the market.

3. HUD's property disposition process should give the Department the flexibility to limit the amount of Section 8 project based rental assistance to the amount necessary to meet the needs of the tenants and community where the project is located. This should include the flexibility for HUD to dispose of properties with no rental assistance if other less expensive viable options for providing the housing exist.

These recommendations are quite similar to the legislative proposal you introduced last week that among other things mandates assessments of troubled projects and the preparation of action plans. In addition, HUD's Assistant Secretary for Housing has established SWAT teams to review troubled projects and their resource needs. We fully support these efforts and intend to work closely with the Assistant Secretary's staff and the Subcommittee to ensure these assessments are implemented effectively

4. We support HUD's proposal to shift Section 8 property disposition from a discretionary funding source to a mandatory account.
5. HUD should be given the flexibility to transfer all or a portion of Section 8 authority from one project to another or from project based assistance to tenant based certificates or vouchers without risk of having Section 8 assistance rescinded.
6. HUD should be given the explicit authority and flexibility to undertake refinancing initiatives involving some form of risk-sharing with Fannie Mae, Freddie Mac, state and local agencies, and others. Only the risk that represents a new incremental risk should be scored when a HUD-insured mortgage is refinanced.
7. HUD should be given the authority and flexibility to use previously budgeted interest reduction payments to pay off the principal on Section 236 mortgages in cases where the balance of the interest reduction payment funding exceeds the principal balance.
8. In the short-term Congress should authorize and appropriate increases in HUD's funding to enable the Department to develop or acquire the capacity and expertise necessary to effectively deal with the problems of troubled projects.
9. Legislation should be passed modifying the Bankruptcy Code to provide the Department with the flexibility to foreclose on defaulted properties in a more timely and

less costly manner. This legislation should also totally exempt the Department from the automatic stay provisions of the Code which prevent the Department from foreclosing on owners and taking possession of their properties.

MULTIFAMILY PRESERVATION AND SECTION 8 CONTRACT RENEWALS

A. Administrative Actions

1. All decisions on continuing assistance to multifamily projects whether preservation or renewal of Section 8 project based assistance should be based on a comprehensive physical, financial, and social impact analysis as proposed for troubled projects.
2. HUD should revise all new Section 8 project based assistance contracts to provide the Department more flexibility to set and adjust contract rents based on comparable market rents.

B. Legislative Actions

1. Congress should repeal all multifamily preservation legislation. This action should terminate all processing so that no more projects are preserved under these statutes. The current multifamily preservation programs eliminate HUD's ability to make decisions on the benefits and need for housing before providing additional taxpayer dollars to owners. All determinations on whether the housing should be funded are either dictated in the statutes or made by the project owner.
2. Legislation addressing Section 8 project based contract renewals is needed that specifically gives the Department the authority to pursue different options for providing the housing necessary to meet the needs of the tenants and the community based on a physical, financial, and social analysis as described for troubled projects. These options need to include reducing or terminating the assistance to any individual project if the analyses determine this is appropriate.

PREVENTION/COST SAVINGS OPPORTUNITIES

A. Administrative Actions

1. HUD needs to refine their system for analyzing projects to detect early warning signs for projects becoming troubled and place greater emphasis on preventative measures to deter project defaults and prevent projects from becoming troubled.

2. HUD should issue regulations regarding rent comparability and its use in setting rents for multifamily projects. The regulations should apply comparability to all projects no matter what method is used for rent increases.
3. HUD should use project reserve funds when ever feasible in lieu of granting rent increases for multifamily projects.
4. HUD should evaluate and modify their systems for compensation of property owners and managers to provide incentives rather than disincentives for improving the efficiency of project operations, increasing tenant involvement in project management decisions, accelerating transfers of ownership, and encouraging the use of nonprofits where appropriate.

ORGANIZATIONAL AND PROGRAM RESTRUCTURING

A. Administrative Actions

1. HUD needs to restructure its multifamily project based assisted/insured programs and delivery systems to give the department the flexibility necessary to provide the types of assistance most beneficial to tenants, communities, and HUD based on physical, financial, and social analyses.
2. FHA should become a more market-oriented entity. Consequently, any overhauling of the multifamily housing programs could be done in conjunction with the restructuring of FHA.

ENFORCEMENT

A. Administrative Actions

1. HUD needs to get tough and use existing enforcement tools. However, HUD's culture has a wholesale disregard for available enforcement tools. To change the culture HUD needs enforcement tools that impact the owner not tenants and the Department, or the flexibility to operate existing programs in a manner that allows use of existing enforcement tools without harming tenants and the Department. All the recommendations we have discussed either provide enforcement tools that will not harm tenants or that will provide the flexibility needed to use existing tools without harming the tenant.

B. Legislative Actions

1. Provisions to improve HUD's enforcement capabilities have been included in HUD's current housing reauthorization bills, although we understand that passage is unlikely this session. These provisions are designed to improve the equity skimming statutes and expand current civil money penalty provisions. We fully support each of these legislative initiatives and urge that they be included in future housing legislation.
2. Our office has already initiated other legislative changes in the statutes to make equity skimming a money laundering offense, and hold owners personally liable for losses incurred by the Federal Government as a result of equity skimming and the obstructing of any Federal audit. I am attaching a copy of these suggested changes to my statement for the Subcommittee's information and consideration.

In conclusion, Mr. Chairman, HUD's Multifamily project based assistance programs are in a state of crisis. Nic Retsinas, Helen Dunlap and their dedicated staff desperately need help from you, your fellow congressmen, OMB and the housing industry to overcome the current situation. Drastic actions are needed now. I truly hope this hearing will help stimulate the needed debate about the future course of affordable rental housing.

Thank you! We will be pleased to respond to any questions.

FINANCIAL ANALYSIS
HOLIDAY LAKE APARTMENTS

1. The Holiday Lake Apartments project, located in Pompano Beach, Florida, is a 232 unit complex that was insured under HUD's Section 236 program in 1972. The 232 units consisted of:

1	bedrooms	78
2	bedrooms	96
3	bedrooms	<u>58</u>
		<u>232</u>

Holiday Lake Apartments currently has 220 assisted units. According to a HUD official, Section 8 assistance for 139 units was received by the project in 1976. In 1984, an additional 46 units were assisted, and in 1994 35 more were added.

In August 1990, HUD determined that the project was a low risk. Therefore, it would not be subjected to further HUD on-site reviews until 1993. The low risk was based on: the satisfactory physical condition; financial reviews that did not raise concerns; and adequate replacement reserves. Further, subsequent FNMA mortgagee inspections in 1991 and 1992 disclosed that the property was in satisfactory physical condition.

In January 1993, the owners requested a rent increase. In March 1993, the tenants took exception to the rent increase because of the physical condition of the project. HUD's on-site management review in May 1993, confirmed the project's physical condition was substandard. As a result, HUD declared the project troubled due to its substandard physical condition.

2. After the management review and physical inspection, HUD's strategy to correct the project's poor physical condition included:
 - Meeting with the owner to require a change in project management and to request that the owner contribute additional cash,
 - Processing a Flexible Subsidy Loan application to provide funds to repair the project, and
 - Providing additional Section 8 assistance for 35 units.

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As of September 14, 1994 the status of HUD's actions were:

- The project's management was changed in January 1994; and according to HUD officials, the owner entity contributed \$210,000 in cash to the project. Also the owner entity paid outstanding payables of \$70,000.
- HUD processed the owner's application for a Flexible Subsidy Loan in the amount of \$856,425 which was reserved for Holiday Lake Apartments in July 1994. However, the final Flexible Subsidy Loan documents has not yet been signed.
- HUD approved Section 8 Loan Management Set-Aside (LMSA) for 35 additional units (effective August 1994).

On September 15, 1994, HUD's Deputy Assistant Secretary for Multifamily Housing Programs made a site visit to Holiday Lake Apartments. Based on her observations, she stopped HUD's approval of the Flexible Subsidy Loan and called for another inspection of all of the units on October 4, 1994. For units not meeting standards, HUD will issue a notice that the owner has 30 days to bring the units up to standards or rental assistance payments will be abated.

3. HUD is now providing Section 8 project based rental assistance to 94 percent of the units. The Section 8 contracts cost HUD \$1 million per year; and the interest reduction payment provides an average payment of \$158,000 per year. Additional Federal financial assistance includes Low Income Housing Tax Credits of \$220,000 per year through 1998.
4. Financial analysis performed by HUD on the project.

The process used by HUD to make decisions on Holiday Lake Apartments included a review of funding sources to pay for the necessary repairs and an analysis of assisting the project with a Flexible Subsidy Loan or foreclosing on the project.

The review of funding sources included funds available from the project and contributions from the owner. HUD then considered the sources available to fund the repairs through HUD programs including Flexible Subsidy Loan and LMSA (Loan Management Set Aside).

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The project owners applied for operating funds to repair the project through HUD's Flexible Subsidy Loan program. Under this program, HUD performed a least cost analysis comparing the cost to assist the project with a operating Flexible Subsidy Loan with the cost to foreclose and sell the project. The analysis showed that it was less costly to provide the operating Flexible Subsidy Loan (\$856,425) rather than foreclose and sell the project (\$1,594,627).

However, our review showed the following problems with HUD's least cost analysis:

- The "best ballpark" sales price was extremely low. HUD used \$250,000 while our appraisal showed a market value of \$2.2 million
- The estimated foreclosure and sale costs did not include all costs that would be incurred such as advertising, repair survey, and financing costs.

If the appraised market value was substituted for the sales price in the least cost analysis, foreclosure and sale of the project would be less costly than providing an operating flexible subsidy loan.

5. The following table shows the federal cost of the Voucher and Rehabilitation Options at different rent levels. The columns in the table show the estimated federal costs of the Voucher and Rehab Options for 15, 20, and 30 years as shown on the left side of the table, and at different rent levels shown in each column. The first column uses the minimum rent level needed to operate and rehabilitate the project with a 15-year loan. The second column uses comparable market rent levels and the last two columns use the stated percentages of the fair market rents. As the rents are increased the cost of vouchers increases faster than the cost of rehabilitating the project. In fact, the increase in cost for the Rehab Option represents increases in revenue not expenses.

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Section 8 Contract Term in (years)	Present value cost of section 8 vouchers			
	Costs for rents	Comparable	Percentage of Fair Market Rent	
	to pay off the	Market		
	15 year loan	rents	85	100
	64.5% of FMR	(as repaired)		
15 years				
Voucher option				
Total cost	\$12,260,480	\$13,008,554	\$16,728,774	\$20,000,281
Rehabilitation option				
Total cost	\$11,930,480	\$12,205,457	\$13,572,940	\$14,775,483
20 years				
Voucher option				
Total cost	\$15,201,367	\$16,133,842	\$20,771,104	\$24,849,044
Rehabilitation option				
Total cost	\$14,708,564	\$15,110,200	\$17,107,563	\$18,864,015
30 years				
Voucher option				
Total cost	\$19,950,093	\$21,180,327	\$27,298,360	\$32,678,468
Rehabilitation option				
Total cost	\$19,291,181	\$19,931,659	\$23,116,800	\$25,917,766

Comparison of the Voucher Option cost at comparable market rents to the Rehabilitation Option cost at rents to pay off a 15 year loan.

Voucher Option cost	\$13,008,554
Rehabilitation Option cost	<u>\$11,930,480</u>
Rehabilitation Option savings	<u>\$ 1,078,074</u>

Comparison of the cost to rehabilitate the project with loan financing versus a grant.

Rehabilitation costs with a loan	\$11,930,480
Rehabilitation costs with a grant	<u>\$ 8,986,365</u>
Rehabilitation savings with a grant	<u>\$ 2,944,115</u>

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Comparison of the cost of the Voucher Option cost at comparable market rents to the Rehabilitation Option cost when a grant is used.

Voucher Option cost	\$13,008,554
Rehabilitation costs with a grant	<u>\$ 8,986,365</u>
Rehabilitation savings with a grant	<u>\$ 4,022,189</u>

Cost to reduce project based assistance to 20 percent of the units and to provide vouchers at comparable market rents to the remaining tenants.

Rehabilitation Option costs	\$11,930,480	
20 percent	<u>20%</u>	<u>\$2,386,096</u>
Voucher Option cost	\$13,008,554	
80 percent	<u>80%</u>	<u>\$10,406,843</u>
Total		<u>\$12,792,939</u>

Comparison of the Voucher Option cost at comparable market rents to the cost or reducing project assistance to 20 percent and providing vouchers.

Voucher Option cost	\$13,008,554
20% project and 80% voucher cost	<u>\$12,792,939</u>
Savings	<u>\$ 215,614</u>

FINANCIAL ANALYSIS
SIERRA NEVADA ARMS

1. The Sierra Nevada Arms project, located in Las Vegas, Nevada, is a 352 unit complex that was insured under HUD's Section 236 program in 1970. The 352 units consisted of:

1	bedrooms	88
2	bedrooms	176
3	bedrooms	<u>88</u>
		<u>352</u>

Sierra Nevada Arms currently has 290 assisted units. The project received Section 8 assistance in four increments: 50 units in 1981, 140 units in 1984, 40 units in 1986, and 60 units in 1988. According to documents in the HUD project files and discussions with HUD officials, the project received the assistance in 1981, 1986, and 1988 to provide assistance to residents paying more than 25 percent of their income for rent and to provide additional income to the project for financial and physical problems. The 140 units of section 8 assistance provided in 1984 was a conversion of the project's rent supplement contract to Section 8.

Sierra Nevada Arms has been classified by HUD as a troubled project for at least 8 years. Since HUD declared Sierra Nevada Arms troubled the project has continued to have both physical and financial problems. According to HUD staff the project is in an area that has deteriorated over the years both physically and socially. Incomes in the area are low and gangs have moved into the area.

In an attempt to alleviate the physical and financial problems at Sierra Nevada Arms, HUD has provided an additional 100 units of Section 8 assistance to the project since declaring the project troubled. However, the projects condition has not improved. In July 1994 HUD performed a management review of the project which revealed an unsatisfactory management rating as well as significant physical deficiencies. In August 1994 the Section 236 mortgage was assigned to HUD and the Las Vegas office processed a recommendation for foreclosure on the mortgage. In September 1994, HUD notified the project owner that they would discontinue payments on the project's four Section 8 contracts if the project's physical condition is not improved.

2. After recommending foreclosure on the mortgage and notifying the project owner of the potential for abatement, HUD's strategy to correct the project's poor physical condition included:

- A 100 percent unit inspection of the project and abating Section 8 payments for all units that do not meet HUD's Section 8 Housing Quality Standards;
- Providing a tenant based Section 8 certificate or voucher to residents in all units for which rents are abated so that they have the opportunity to find alternate housing; and
- Actively pursuing a transfer of physical assets to new ownership.

As of September 22, 1994 the status of HUD's actions were:

- The 100 percent unit inspection is scheduled to begin on October 11, 1994. Certificates or vouchers will be available and issued immediately upon failing any unit for Housing Quality Standard deficiencies.
 - HUD had received one Transfer of Physical Assets application for Sierra Nevada Arms. However, the application was sent back to the organization because it was dependent on State tax credits which the State would not provide.
 - According to HUD staff in Las Vegas they would prefer to actively pursue a Transfer of Physical Assets rather than foreclose on the mortgage. Two organizations in the Las Vegas area have expressed interest in purchasing the property.
3. HUD is now providing Section 8 project based rental assistance to 82 percent of the units and a monthly interest reduction payment. The rental assistance contracts cost HUD \$1.1 million per year and is providing an average interest reduction payment of \$295,800 per year.
4. Financial analysis performed by HUD on the project.

HUD does not make comprehensive analysis of various alternatives for troubled projects.

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For Sierra Nevada Arms HUD has only performed the required reviews of monthly accounting reports and audited financial statements for troubled projects. The purpose of these reviews is to detect specific financial problems at the project.

5. The following table shows the federal cost of the Voucher and Rehabilitation Options at different rent levels. The columns in the table show the estimated federal costs of the Voucher and Rehab Options for 15, 20, and 30 years as shown on the left side of the table, and at different rent levels shown in each column. The first column uses the minimum rent level needed to operate and rehabilitate the project with a 15-year loan. The second column uses comparable market rent levels and the last two columns use the stated percentages of the fair market rents. As the rents are increased the cost of vouchers increases faster than the cost of rehabilitating the project. In fact, the increase in cost for the Rehab Option represents increases in revenue not expenses.

Section 8	Present value cost of section 8 vouchers			
	Costs for rents to pay off the 15 year loan (years)	Comparable Market rents (as repaired)	Percentage of Fair Market Rent	
	59.4% of FMR		85	100
15 years				
Voucher option				
Total cost	\$16,030,465	\$17,483,063	\$23,786,423	\$28,331,217
Rehabilitation option				
Total cost	\$15,595,465	\$14,130,689	\$18,446,408	\$20,116,968
20 years				
Voucher option				
Total cost	\$19,874,778	\$20,607,931	\$29,542,595	\$35,207,690
Rehabilitation option				
Total cost	\$19,127,808	\$18,587,510	\$23,291,934	\$25,732,005
30 years				
Voucher option				
Total cost	\$26,082,290	\$24,741,366	\$38,837,235	\$46,311,309
Rehabilitation option				
Total cost	\$25,017,014	\$20,039,330	\$31,657,432	\$35,548,548

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Comparison of the Voucher Option cost at comparable market rents to the Rehabilitation Option cost at rents to pay off a 15 year loan.

Voucher Option cost	\$17,483,063
Rehabilitation Option cost	<u>\$15,595,465</u>
Rehabilitation Option savings	<u>\$ 1,887,598</u>

Comparison of the cost to rehabilitate the project with loan financing versus a grant.

Rehabilitation costs with a loan	\$15,595,465
Rehabilitation costs with a grant	<u>\$11,553,841</u>
Rehabilitation savings with a grant	<u>\$ 4,041,624</u>

Comparison of the cost of the Voucher Option cost at comparable market rents to the Rehabilitation Option cost when a grant is used.

Voucher Option cost	\$17,483,063
Rehabilitation costs with a grant	<u>\$11,553,841</u>
Rehabilitation savings with a grant	<u>\$ 5,929,222</u>

Comparison to reduce project based assistance to 20 percent of the units and to provide vouchers at comparable market rents to the remaining tenants.

Rehabilitation option costs	\$15,595,465	
20 percent	<u>20%</u>	\$ 3,119,093
Voucher Option cost	\$17,483,063	
80 percent	<u>80%</u>	\$13,986,450
Total		<u>\$17,105,543</u>

Comparison of the Voucher Option cost at comparable market rents to the cost or reducing project assistance to 20 percent and providing vouchers.

Voucher Option cost	\$17,483,063
20% project and 80% voucher cost	<u>\$17,105,543</u>
Savings	<u>\$ 377,520</u>

METHODOLOGY

Computation Methodology for the Financial Analysis of the Holiday Lake Apartments and Sierra Nevada Arms Apartments

1. Replacement of project based rental assistance with tenant based rental assistance provided through vouchers.
 - A. Cost of tenant based rental assistance (Vouchers)
 - (1) We determined the maximum yearly rental assistance payments for the number of project units based on comparable rents and various levels of the fair market rent.
 - (2) We adjusted the maximum yearly rental assistance payments for the anticipated annual increase in rents.
 - (3) To estimate the rental assistance needed we adjusted the anticipated maximum yearly rental assistance payments for estimated occupancy levels and resident contributions.
 - (4) We determined the present value of the stream of rental assistance payments.
 - (5) We estimated the additional costs for relocation of residents.
 - (6) We estimated the total cost of tenant based rental assistance by adding the present value of the stream of rental assistance payments and the relocation costs.
 - B. Cost of rehabilitating the project and providing project based rental assistance.
 - (1) We estimated the project income and expenses to determine the cash flow available for debt service.
 - (2) Based on the estimated cash flow we determined the maximum mortgage amount that could be amortized. We estimated the rehabilitation costs for the project.
 - (3) We compared the maximum mortgage amount and the rehabilitation costs to determine if project income would be sufficient to make debt service payments or if a added federal assistance would be needed.
 - (4) We estimated the cost of rehabilitating the project and providing rental assistance.
 - C. We varied the rental levels used in computations of A and B above.

- D. We compared the estimated costs.
2. To perform this analysis we used several assumptions. We assumed:
- (A) There were no federal housing laws that limited HUD's actions to address the troubled projects.
 - (B) The existing outstanding mortgage would be paid off under both the voucher and rehabilitation options so they need not be considered under either option.
 - (C) That there are no other costs associated with the existing outstanding mortgage other than the principle and interest reduction payments.
 - (D) For comparison purposes the rental assistance amount is the same for the voucher and rehabilitation options.
 - (E) Section 8 rental assistance would be provided for each project unit as project based or tenant based depending on the action being evaluated.
 - (F) The residents receiving Section 8 rental assistance would contribute the same amount towards rent under either the Voucher or Rehab Options.
 - (G) Project operating expenses would be the same as reflected in the latest audited financial statement.
 - (H) Project operating costs will increase at the same rate as estimated rent increases.
 - (I) Rents would increase at the same rate as the Section 8 Existing Fair Market Rents between 1986 and 1993.
 - (J) The deposits to the project reserve for replacements would be increased to the amount projected by project management after taking rehabilitation into consideration.
 - (K) The rehabilitation costs estimated by HUD were accurate for the necessary repairs to make the project decent safe and sanitary.
 - (L) For revenue purposes, we estimated that vacancy rates would be 5 percent.

PURSuing ALTERNATIVES TO HUD'S "TROUBLED" ASSISTED HOUSING PROJECTS

AVAILABLE OPTIONS	DECISION INFORMATION	ADDITIONAL HUD NEEDS
- Restructure Project Debt	Project:	- Improved Capacity
- Increase Project Subsidy	- Ownership Conditions	o In-house
- Fund Physical Improvements	- Management Conditions	o Contracting
- Change Project Management	- Physical Conditions	o Outsourcing
- Change Project Ownership	- Financial Conditions	- Improved Data Systems
- Terminate Subsidy/Move Tenants	- Tenant/Occupancy Conditions	o Development
- Preserve Under ELIHPA/LIHPRHA	Market:	o Maintenance
- Sell HUD-Held Mortgages	- Neighborhood Environment	- "Flexibility" in Decisions to Preserve or Dispose of Properties, and to Renew or Transfer Subsidies
- Dispose of HUD-Owned Property with Subsidy	- Rent Comparability	o Unrestricted Contract
	- Existing Alternative Housing Sources	o Renewal Authority
	- Housing Replacement Costs	o Authority to Reuse Terminated Subsidy Contract Funding
		o Authority to Convert Project-Based to Tenant-Based Subsidy
		o Repeal of ELIHPA/LIHPRHA Provisions for Forced Preservation
		o Repeal of Subsidy Requirements for HUD Property Disposition
		- Program Structure Changes
		o Increase Owner's Stake in Future Insured Projects
		o Remove Bankruptcy Code Barriers to Protecting HUD and Tenant Interests
		o Strengthen Enforcement Provisions Against Owners
		o Repeal Owner Driven CNAs and the LMSA Program

Mr. PETERSON. Thank you very much.

Ms. Joseph.

STATEMENT OF JUDY ENGLAND-JOSEPH, DIRECTOR, HOUSING AND COMMUNITY DEVELOPMENT ISSUES, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY DENNIS FRICKE, ASSISTANT DIRECTOR

Ms. ENGLAND-JOSEPH. Good morning, Mr. Chairman and members of the subcommittee.

We are pleased to be here today to follow up on our earlier testimony on the Department of Housing and Urban Development's Section 8 project-based assisted housing programs. These programs, as you know, provide rental assistance to over 20,000 privately owned properties and 1.5 million low-income households nationwide at an estimated annual cost of \$5.8 billion.

My previous testimony focused on assisted properties where low-income families are living in very, very poor physical conditions. And because of this subcommittee's ongoing concern about these conditions and questions raised about HUD's ability to effectively respond to these problems, you asked us to, one, compare the cost of rehabilitating two physically distressed properties, Edgewood Terrace Apartments in Washington, DC and 6000 South Indiana Apartments in Chicago, IL, with the cost of providing certificates and vouchers; two, determine the views of tenants and community leaders about these options; and three, identify legislative and administrative factors limiting HUD's discretion in dealing with physically distressed properties.

In conducting our analysis, we had the two properties appraised, documented the rents in the areas where these properties are located, met with tenants and community leaders to obtain their views on the options examined, met with HUD officials to discuss actions the Department has taken on these and similarly distressed properties, and met with HUD's attorneys to discuss current laws on property disposition that affect HUD's decisions.

In considering the options for both Edgewood Terrace Apartments and 6000 South Indiana Apartments, we did not limit ourselves by current law requiring HUD to preserve subsidized multi-family properties for low-income families.

In summary, we found the following. Because the costs of the housing alternatives differ depending on each and every property, physically distressed properties need to be analyzed and decisions made on each of those properties on a case-by-case basis. Rehabilitating Edgewood Terrace Apartments could result in Federal costs that are millions of dollars higher than the cost of providing certificates and vouchers. At 6000 South Indiana Apartments, the costs of rehabilitation are comparable to the costs of providing certificates and vouchers.

Although tenants were generally very dissatisfied with the current conditions at both Edgewood Terrace Apartments and 6000 South Indiana Apartments, their views were mixed on whether they would prefer to remain in their current residences or be given the choice of moving elsewhere. And community leaders in these neighborhoods generally believed that the properties should be rehabilitated.

Current laws limit HUD's discretion in dealing with physically distressed properties. Providing HUD with more options could allow the Department to make more cost-effective decisions about its housing assistance.

And finally, HUD lacks a comprehensive strategy for focusing on these properties and its management information systems are poor. As a result, the Department is not systematically identifying and addressing conditions in its most physically distressed properties.

Current housing policy has generally supported preserving subsidized housing and has not required HUD to consider housing alternatives. As we stated in our earlier testimony, the current budgetary climate requires all Federal agencies to consider the cost implications of their policy decisions. Yet, in dealing with its portfolio of physically distressed properties, HUD is limited by legislation that precludes it from using funds recaptured from terminated Section 8 contracts to relocate tenants from these severely distressed properties to other properties of higher quality. And current laws also limit HUD's discretion to use vouchers and certificates in dealing with physically distressed properties. Providing HUD with greater flexibility in using certificates and vouchers would require congressional action.

In dealing with distressed properties, it is important that HUD balance fiscal responsibility and the interest of affected tenants and communities. We support the provisions of H.R. 5115 that would require these cost implications along with other factors like the views of tenants and community leaders to be carefully weighed in HUD's decision on how to proceed with individual properties. We also support the bill's provision that would authorize the Department to use recaptured Section 8 program funds to relocate tenants currently living in physically distressed properties by offering them vouchers and certificates.

HUD is limited by inadequate information systems, as you have just heard, and the lack of a comprehensive strategy which would focus on these very properties that are severely distressed. While improved financial and management information systems are critical for the ongoing management of this inventory of assisted properties and capital needs assessments are crucial for determining repair costs, current limitations in these data sources do not and should not preclude HUD from systematically identifying those assisted properties that are in the worst physical condition. Simple walkthrough inspections by either HUD field office staff or outside inspectors could provide HUD immediately with information on how many properties are in conditions similar to those that we reported to you in July 1994. This information, together with data from the past inspection reports on the properties, would put HUD in a position to systematically notify property owners of the need to address physical problems, and take appropriate enforcement action when owners do not bring their properties into compliance with housing quality standards.

Finally, we recognize that HUD faces some very difficult and serious challenges in dealing with properties that have fallen into serious disrepair. For some properties that are obsolete and located in unstable neighborhoods, the decision to dispose of the property, if HUD had the legal discretion, would not be a difficult one. On

the other hand, properties like Edgewood Terrace Apartments, if rehabilitated, have excellent potential as a low-income housing resource. However, because, in this case, rehabilitation costs exceed by millions of dollars the cost of housing families with vouchers and certificates, the Department is actually faced with a very difficult decision.

And it is with that decision that I would like to offer a final observation. For every \$1 million spent to rehabilitate a property like Edgewood Terrace, in excess of what it would cost to provide vouchers and certificates for alternative housing, approximately another 150 families could be provided with housing assistance for 1 year. This is not an inconsequential number considering the Nation's sizeable homeless population and the fact that today, for every household that receives housing assistance, there are actually two other eligible households that do not.

That ends my prepared statement, sir. I would be happy to answer any questions you and the committee members might have. [The prepared statement of Ms. England-Joseph follows:]

United States General Accounting Office

GAO

Testimony

Before the Employment, Housing and Aviation Subcommittee
Committee on Government Operations,
House of Representatives

For Release on Delivery
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FEDERALLY ASSISTED
HOUSING

Expanding HUD's Options for
Dealing with Physically
Distressed Properties

Statement of Judy A. England-Joseph,
Director, Housing and Community Development Issues,
Resources, Community, and Economic Development Division



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to follow up on our earlier testimony on the Department of Housing and Urban Development's (HUD) Section 8 project-based assisted housing programs.¹ Under these programs, HUD pays a portion of the rent for low-income families living in privately owned rental housing. HUD provides this assistance for over 20,000 privately owned properties nationwide at an estimated annual cost of \$5.8 billion. The mortgages for about 10,000 of these properties are also insured or held by HUD.

Although many of these properties are considered to be in good physical condition, our previous testimony focused on assisted properties where low-income families are living in very poor physical conditions. Because of the Subcommittee's ongoing concern about these conditions and questions raised about HUD's ability to effectively respond to these problems, you asked us to (1) compare the costs of rehabilitating two physically distressed properties with the costs of other alternatives for housing the tenants, (2) determine the views of tenants and community leaders on these options, and (3) identify legislative and administrative factors limiting HUD's discretion in dealing with physically distressed properties.

At the Subcommittee's request, our testimony today is based on analyses of two properties discussed in our earlier testimony: Edgewood Terrace Apartments in Washington, D.C., and 6000 South Indiana Apartments in Chicago, Illinois. While we recognize that factors other than cost can influence decisions about dealing with distressed properties, the current budgetary climate requires

¹Federally Assisted Housing: Conditions of Some Properties Receiving Section 8 Project-Based Assistance Is Below Housing Quality Standards (GAO/T-RCED-94-273, July 26, 1994).

federal agencies to carefully weigh the cost implications of their policy decisions. As directed by the Subcommittee, we compared the costs of rehabilitating the two properties and the costs of housing tenants in these properties after rehabilitation with the costs of providing alternative housing assistance. Although our analyses assumed that HUD's choices among the options were not restricted by current laws and regulations, our earlier testimony and this statement discuss factors limiting HUD's discretion in dealing with federally subsidized properties.

In conducting our analyses, we had the two properties appraised, met with tenants and community leaders to obtain their views on the options we examined, and met with HUD officials to discuss and document actions the Department has taken to deal with these and similarly distressed properties. In addition, we met with HUD attorneys to discuss current laws on property disposition that affect HUD's decisions.

In summary, we found the following:

- Because the costs of the housing alternatives differ depending on the property, physically distressed properties need to be analyzed on a case-by-case basis. Rehabilitating Edgewood Terrace Apartments could cost millions of dollars more than providing the tenants with alternative housing in the community. At 6000 South Indiana Apartments, the costs of rehabilitation are comparable with the costs of providing alternative housing.
- Although tenants were generally very dissatisfied with the current conditions at both Edgewood Terrace Apartments and 6000 South Indiana Apartments, their views were mixed on whether they would prefer to remain in their current residences or be given the choice of moving elsewhere. Community leaders in the neighborhoods of both properties

generally believe that the properties should be rehabilitated.

- Current laws limit HUD's discretion in dealing with physically distressed properties. Providing HUD with more options could allow the Department to make more cost-effective decisions about its housing assistance.
- HUD lacks a comprehensive strategy for focusing on these properties, and its management information systems are poor. As a result, the Department is not systematically identifying and addressing conditions in its most physically distressed properties.

Before discussing these findings in detail, we would like to provide you with some background information.

BACKGROUND

HUD's Section 8 project-based rental assistance programs² were established under Section 8 of the United States Housing Act of 1937, as amended (42 U.S.C. 1437 et seq.). The subsidies provided under these programs allow about 1.5 million lower-income households to obtain housing from private owners. Households

²Unlike tenant-based subsidies, project-based subsidies are attached to particular property units. The primary project-based assistance programs are the (1) Section 8 Property Disposition program, which provides assistance to ensure that properties acquired by HUD through foreclosure and eventually resold are maintained as low-income housing; (2) Section 8 Loan Management Set-Aside program, which provides assistance to projects with HUD-insured and HUD-held mortgages that are experiencing immediate or potentially serious financial difficulties; and (3) Section 8 New Construction and Substantial Rehabilitation programs, which provide assistance to private developers to construct new units or to substantially rehabilitate units for rental to low- and moderate-income families.

receiving this assistance must live in designated properties, and they are generally required to pay 30 percent of their income for rent. HUD enters into housing assistance payment contracts with the owners of the properties and provides rent subsidies to them. The subsidy represents the difference between the tenant's payment and the agreed-upon rent. Because these rent subsidies are attached to particular units, tenants who move lose their rental assistance unless they move to another subsidized unit.

In addition to project-based assistance, two types of tenant-based rental assistance--certificates and vouchers--are provided under HUD's Section 8 programs. Another 1.3 million households use certificates or vouchers to obtain housing. Tenant-based assistance differs from project-based assistance in that households may use certificates or vouchers to rent from owners of their choice, provided the units meet HUD's requirements for rent levels and housing quality standards for decent, safe, and sanitary housing.

Physically distressed multifamily properties, including some receiving Section 8 project-based assistance, may require additional financial assistance from HUD to improve their conditions and ensure their continued financial viability. The primary forms of remedial assistance available are the Flexible Subsidy Program and the Section 8 Loan Management Set-Aside Program. The Flexible Subsidy Program provides, among other things, reduced-interest loans to improve the physical conditions of older properties that receive interest subsidies for their HUD-insured mortgages.³ The Section 8 Loan Management Set-Aside

³During the 1960s, two major low-interest mortgage loan programs were created to offer incentives for the development of affordable rental housing. Under the Section 221(d)(3) Below Market Interest Rate program and the Section 236 Mortgage Insurance and Interest Reduction Payments program, sponsors of low- and moderate-income housing received subsidies on interest rates for their HUD-insured mortgages and rent subsidies for qualified tenants.

Program provides additional funds to a distressed property through increases in rental income.

COSTS OF ALTERNATIVES DIFFER
DEPENDING ON THE PROPERTY

The costs of the alternatives--rehabilitating and continuing to provide project-based rental subsidies or providing alternative housing through certificates and vouchers--varied between the two properties we reviewed. Rehabilitating Edgewood Terrace Apartments to preserve all its units would be more costly than providing certificates or vouchers to an equivalent number of families and significantly more costly than providing such assistance only to the tenants currently residing there. At 6000 South Indiana Apartments, the rehabilitation costs are comparable to the cost of providing the tenants with certificates or vouchers.

Edgewood Terrace Apartments

At Edgewood Terrace Apartments, a 292-unit complex in northeast Washington, D.C., HUD provides Section 8 project-based assistance for 114 units, all of which were occupied as of August 31, 1994. The remaining 178 units are vacant. The property was sold to its current owner in 1983. Subsequently, the owner defaulted on the federally insured mortgage, which HUD now holds. HUD is considering several proposals from a nonprofit corporation that wants to acquire Edgewood Terrace Apartments.

We analyzed the costs over 15 years of three options for this complex:⁴

- rehabilitating the entire complex and providing Section 8 project-based assistance for all 292 units,

⁴We chose 15 years because it is the expected length of a Section 8 contract.

- providing 292 families with certificates or vouchers that would allow them to obtain alternative housing,⁵ and
- providing certificates or vouchers to the 114 families currently receiving assistance.

To evaluate the rehabilitation costs, we began with a detailed assessment of capital needs prepared by the nonprofit corporation interested in acquiring the property. According to this assessment, it will cost approximately \$20.8 million to comprehensively rehabilitate the property.

Next, we examined alternatives for financing the costs of rehabilitation through a mixture of debt financing (mortgage) and cash investment. Because the amount of cash investment is directly related to the property's rental income, we assumed three different rent levels in our analysis. The first level of rents represents a slight upward adjustment of the market rents currently charged for unsubsidized units in well-maintained properties in the neighborhood of Edgewood Terrace Apartments. This upward adjustment recognizes the value of the improvements that would be made to the property through rehabilitation. We set the next two rent levels at different percentages of the HUD-established fair market rent (FMR)⁶ for the entire market area in order to evaluate different combinations of the initial cash investment required and

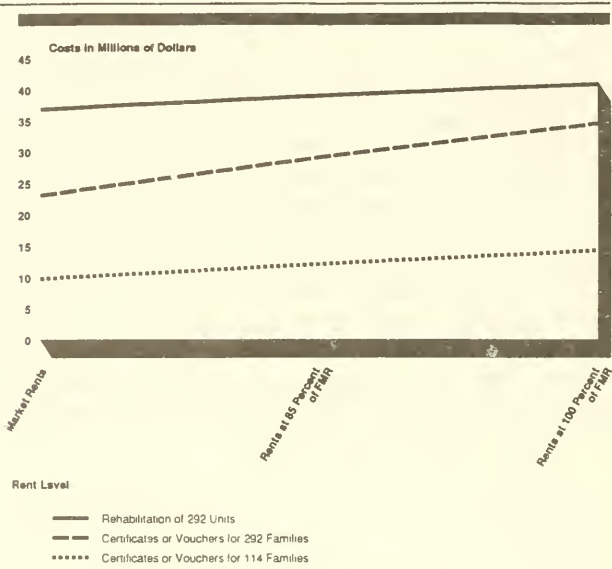
⁵Providing Section 8 subsidies for 292 families, whether through rehabilitation or the alternative option of certificates and vouchers, represents the maximum potential federal cost under either option. Subsidizing fewer units would result in comparable cost reductions for both options.

⁶In general, the fair market rent (FMR) for an area is the amount needed to pay the gross rent (shelter plus utilities) for modest, decent, safe, and sanitary housing. HUD sets the FMR at the 45th percentile of a market area's rental housing; that is, the level at which about 45 percent of an area's rental housing can be obtained.

the amount of debt that could be supported by the property's rental income. We also used these rent levels to compare the costs of rehabilitation and continued rental subsidies with the costs of housing tenants with certificates and vouchers.

As figure 1 shows, the costs to rehabilitate Edgewood Terrace Apartments and provide 15 years of subsidized assistance to its tenants is clearly higher than providing certificates and vouchers to either 292 or 114 families. Depending on the rent level established for the units, and therefore the government's continuing subsidy, we estimate that the costs to rehabilitate plus provide project-based assistance for all 292 units will range from \$36.9 million to \$40.9 million. Providing certificates or vouchers for 292 families for 15 years would cost from \$23.1 million to \$34.6 million, depending on the rents certificate and voucher holders are charged for their units. The least costly alternative is to provide comparable assistance to the 114 families now receiving Section 8 subsidies. We estimate these costs to range from \$9.8 million to \$14.3 million.

Figure 1: Comparative Costs of the Three Options at Three Rent Levels



Comparing the cost of rehabilitating Edgewood Terrace Apartments with the cost of providing a comparable number of families with certificates and vouchers depends on two key variables: first, the way the rehabilitation costs are financed; and second, the rent levels and the government's resulting cost for units chosen by families using the certificates or vouchers. Any of the rehabilitation and continued subsidy costs shown in figure 1 can be compared with the cost of providing certificates and vouchers at various rent levels. However, regardless of which option is chosen, certificates and vouchers are always less costly

than rehabilitation and the related subsidies for Edgewood Terrace Apartments.

For example, financing the \$20.8 million in rehabilitation costs at market rents would require an initial cash investment of about \$15.1 million (see app. I). This cash investment, along with the \$21.8 million⁷ in rental subsidies that would be needed to support 292 families in the rehabilitated property for 15 years, equals the total cost of \$36.9 million shown in figure 1. When these costs are compared with the cost of providing families with certificates or vouchers in neighborhoods where rents are 85 percent of FMRs,⁸ certificates and vouchers would be less expensive by about \$7.8 million (\$36.9 million minus \$29.1 million). If, on the other hand, a greater portion of the rehabilitation costs were financed through higher rents (assume 100 percent of the FMR), then the total cost of rehabilitating the property and providing rental subsidies over 15 years would be about \$40.9 million. If this total is compared with the costs of providing subsidies for 15 years to tenants electing to use vouchers and certificates in areas where market rents are comparable to those in the Edgewood area, the cost difference between the options would increase to about \$17.8 million (\$40.9 million minus \$23.1 million).

As expected, the comparative costs of providing certificates and vouchers for only 114 families would be substantially less than rehabilitating the entire complex of 292 units. Specifically, if

⁷Our rental subsidy cost estimates represent the net present value of future rental subsidies, discounted at an annual rate of 7.5 percent.

⁸Edgewood Terrace Apartments is located in an area where good-quality housing rents at about 70 percent of the FMR. Consequently, when making comparisons between rehabilitating and providing certificates and vouchers, it is important to recognize that areas where rents are at 85 and 100 percent of the FMR have greater economic value, generally because of added amenities, than the Edgewood market area.

these 114 families relocated to properties where rent levels were 85 percent of the FMR, and the rehabilitation of Edgewood Terrace Apartments were financed at similar rents, the cost difference between these options would be about \$29.1 million (39.0 million in rehabilitation and related Section 8 subsidies minus \$9.9 million, the costs of certificates or vouchers over 15 years for 114 families).

In our cost computations for certificates and vouchers we included the costs of relocating the tenants and disposing of Edgewood Terrace Apartments. Also, we recognize that comparing the costs of rehabilitation with the costs of certificates and vouchers presumes that these two options are equally viable; that is, that rental units are available in the community at or below the FMR and that landlords will be willing to rent to tenants who use certificates or vouchers. In appendix II, we discuss the viability of this type of assistance in the Washington, D.C., market.

Finally, while the principal focus of our analyses comparing the two options was on cost, we recognize that other factors associated with the property also need to be considered. For example, Edgewood Terrace Apartments is well located with respect to employment, neighborhood services, and public transportation. It also has excellent access to hospitals, colleges, and businesses. Given these and other advantages, if the property were rehabilitated it could offer excellent potential as a low-income housing resource. However, this potential has to be weighed against the significant costs of rehabilitation. For every \$1 million spent to rehabilitate a property like Edgewood in excess of the cost to provide alternative housing through certificates and vouchers, approximately 150 more families could be provided with housing assistance for 1 year. This is not an inconsequential number considering the nation's sizeable homeless population and the fact that today, for every household that receives housing assistance, two other eligible households do not.

6000 South Indiana Apartments

We also analyzed the cost of rehabilitating 6000 South Indiana Apartments and compared it with the cost of providing 70 families with certificates or vouchers. At this 12-story property, located on the south side of Chicago, Illinois, HUD provides Section 8 project-based assistance for 68 of the 70 units. As of September 30, 1994, nine units were vacant. In 1988, the project's owner defaulted on the federally insured mortgage, which HUD now holds. Earlier this year, HUD approved a substantial increase in the property's rents in order to fund renovations estimated to cost \$1.3 million.

Again, comparisons between the costs of rehabilitating 6000 South Indiana Apartments and the costs of providing an equivalent number of families with certificates or vouchers depends on both how the rehabilitation is financed and how much rent is charged on units for families using certificates and vouchers. Given the actual financing arrangements made for rehabilitating these apartments and, considering the additional costs of providing 15 years of Section 8 assistance to the residents, we estimate the total costs to be \$5 million. While there is some variation in costs between this option and that of relocating the tenants and providing them with certificates or vouchers for 15 years, the cost of the latter option also approximates \$5 million.

VIEWS OF TENANTS AND COMMUNITY LEADERS

In order to solicit the views of a broad group of tenants, we either posted notices at the properties inviting tenants to meet with us or contacted them directly by telephone. The tenants we spoke with, although generally dissatisfied with the physical conditions at both Edgewood Terrace and 6000 South Indiana Apartments, had mixed views on whether they would prefer to continue living in their current residences or be given the chance

to move elsewhere with a certificate or voucher. However, community leaders active in community development, business, government, and social services in the neighborhoods of these properties generally agreed that both should be rehabilitated and preserved as low-income housing. They noted, however, that the social problems affecting the tenants and the properties would also have to be addressed to ensure the properties' viability.

Tenants' Views

The majority of tenants that we spoke with at Edgewood Terrace characterized the condition of their apartments as either fair, poor, or very poor. Tenants were also unhappy with the way the property has been managed over the years and the way its physical condition has been allowed to deteriorate. Many also noted that the property and surrounding neighborhood suffer from a serious drug problem. Despite these problems, however, some of the tenants noted that they like Edgewood because, among other things, it is convenient to amenities such as stores and transportation.

When asked whether they would like to continue living in Edgewood or be given the chance to find alternative housing using a voucher or certificate, tenants responded differently, in part depending on their age. Many of the elderly tenants we spoke with said that they would rather continue to live in Edgewood than move.⁹ However, they noted that they would like to see major improvements in Edgewood's physical condition, the way the property is managed, and the security that is provided. They would also like to see the drug problem eliminated. Among the reasons they cited for wanting to stay at Edgewood were its convenience to shopping and the length of time they have lived there. Some also

⁹HUD defines an elderly person as one who is 62 years of age or older.

expressed concern about whether they would be able to locate alternative housing using a voucher or certificate. (See app. II.)

Many of the nonelderly tenants we spoke with said they would rather move from Edgewood. However, some had concerns about whether they would be able to locate alternative housing.

At 6000 South Indiana Apartments, almost all of the tenants we spoke with said that their units were in fair, poor, or very poor condition. Many expressed concern about problems with gangs and drugs in the neighborhood. Tenants cited mismanagement by the owner as the primary cause of the building's poor physical condition. The majority of those we interviewed said they would move to other housing if they could obtain the same low rent they are paying now.

Community Leaders' Views

The community leaders near Edgewood Terrace Apartments favored rehabilitation because they considered the property a valuable housing resource that had fallen into disrepair as a result of years of mismanagement and poor oversight by housing officials. They generally agreed, however, that without efforts to address the social and economic needs of the tenants, physical improvements to the property would not be enough. In their view, the tenants at Edgewood need access to social services, education, training, and jobs.

Community leaders in the neighborhood of 6000 South Indiana Apartments were also in favor of rehabilitating the property rather than giving the tenants vouchers or certificates to move elsewhere. In their view, rehabilitation would help the community avoid the problems of having another vacant building or vacant lot. They also considered it important to address the social and economic needs of the tenants. Community leaders blamed HUD for not taking

swift action against the owner when the property's problems became known in 1989.

CERTAIN REQUIREMENTS LIMIT HUD'S
DISCRETION IN DEALING WITH PHYSICALLY
DISTRESSED PROPERTIES

Current legislation and regulations on property disposition limit HUD's discretion in dealing with physically distressed properties. Under these requirements, HUD must generally provide Section 8 project-based assistance to units in a project that previously received it. Other units in the property that did not receive project-based assistance may be subject to restrictions on the amount of rent that can be charged. In addition, if HUD cancels Section 8 project-based assistance at a project in serious disrepair, it cannot now use those funds for other housing assistance.

Preservation Requirements
Limit HUD's Options

In disposing of a multifamily property that it owns, HUD must decide whether to preserve it as rental housing for low-income persons or not to preserve it, possibly resulting in the property's demolition. The Multifamily Housing Property Disposition Reform Act of 1994 mandates that HUD follow certain procedures when disposing of multifamily properties. One of the act's major goals is to preserve housing so that it remains available to and affordable by low-income persons.

Under the law, if HUD decides to preserve the property as low-income rental housing, it may provide project-based assistance to the new owner or certificates or vouchers to the property's tenants. However, these options are subject to certain requirements and limitations, depending on whether the project was originally (1) subsidized with mortgage-related assistance, (2)

subsidized with Section 8 project-based rental assistance, or (3) unsubsidized.

In general, HUD must provide Section 8 project-based assistance to any units in a project that previously received it. If a project received mortgage-related assistance, HUD is required to ensure that any units that did not previously receive project-based assistance remain available to and affordable by low-income persons, and new owners may be required to establish restrictions on use or rent levels so the units remain affordable.

With the goal of creating mixed income projects, the act permits HUD to reduce the number of units that receive project-based assistance in subsidized projects if HUD (1) uses either rent restrictions or project-based assistance to set aside an equal number of units in unsubsidized properties in the same market area to be used as affordable housing for very-low-income families and (2) makes tenant-based assistance available to every low-income family residing in a unit for which HUD is required to provide project-based assistance.

HUD is subject to certain limitations if it decides to provide tenant-based assistance rather than project-based assistance to a project. Tenant-based assistance can only be offered

- in lieu of project-based assistance when projects are located in markets that have an adequate supply of habitable and affordable low-income housing,
- if HUD determines that low-income housing will be available to the tenants who receive such assistance, and
- for up to 10 percent of the aggregate number of subsidized or formerly subsidized units that HUD disposes of in any fiscal year.

HUD may decide not to preserve a physically distressed property as rental housing for low-income persons, which may result in the property's demolition. However, under HUD's regulations, this decision may be made only under one or more conditions, including the following: (1) the costs of rehabilitation are such that rents for existing housing will be higher than 144 percent of the FMR for subsidized projects and the rents obtainable in the market for unsubsidized projects; (2) preservation is not feasible because of environmental factors that cannot be mitigated by HUD or the purchaser of the property; (3) rehabilitation would cost substantially more than constructing new housing; or (4) HUD conclusively demonstrates that decent and affordable low-income housing is not needed in the community for current residents or people who want to live in the community.

Proposed Legislation Would Increase
HUD's Discretion and Focus Attention
on the Most Severely Distressed Properties

Legislation has been proposed that would (1) increase HUD's discretion in dealing with physically distressed properties (S. 2281) and (2) direct HUD to give priority to its most severely distressed properties and make decisions that consider both the costs and social implications of different housing alternatives (H.R. 5115). However, it is still unclear how the preservation requirements discussed above would affect the implementation of these legislative proposals.

HUD has the authority to terminate project-based assistance in properties that are in poor physical condition. However, under appropriations law, if this assistance is terminated, these "recaptured" funds must be returned to the Treasury and cannot be used by HUD to relocate tenants in decent housing in the community. Under one provision in S. 2281, HUD would be allowed to use these

recaptured funds to provide either certificates or vouchers to the tenants or alternative project-based assisted housing.

This proposed provision raises a question as to how the preservation requirements would apply when HUD becomes the owner of a property that is forced into foreclosure proceedings as a result of HUD's decision to terminate the property's contract for project-based assistance. As mentioned previously, HUD is generally required to provide project-based assistance to those units that previously received it. Consequently, if appropriations law were changed to give HUD the authority to use recaptured project-based assistance funds to relocate tenants in decent housing in the community, HUD might need an equivalent amount of additional budget authority to provide project-based assistance if it wished to sell a distressed property.

H.R. 5115, recently introduced by the Subcommittee Chairman, is aimed at improving HUD's management of the Section 8 project-based assistance program. In summary, the bill calls for HUD to (1) identify severely troubled properties; (2) analyze the financial and social impacts in order to assist the Department in determining what remedial actions need to be taken on distressed properties; and (3) choose the most cost-effective action to take, while considering its effect on tenants, owners, and the community.

HUD LACKS INFORMATION TO SYSTEMATICALLY IDENTIFY AND ADDRESS CONDITIONS IN THE MOST PHYSICALLY DISTRESSED PROPERTIES

HUD's ability to identify and address conditions in the most physically distressed properties is impaired because the Department lacks the information needed to do so. Furthermore, HUD has not yet begun, as required by law, to collect information on the financial and other assistance needed by owners of older, assisted multifamily properties. Although HUD has begun several initiatives, it has not initiated a comprehensive effort to

identify those Section 8 properties in the worst physical condition, nor has it developed a strategy to systematically address the problems with those properties. Doing so is critical in order to (1) determine with greater certainty the magnitude of the problem nationwide and (2) give priority to those families living in the worst conditions. The Congress and the administration also need this information in considering the implications of different housing policies and choices.

Problems in HUD's Data Systems Impede Effective Actions

As we stated in our July testimony, one of HUD's major limitations is poor management information systems. More specifically, HUD's ability to routinely identify and monitor properties in deteriorating physical condition is impaired because the Department's information systems do not contain the data needed to do so. HUD is making progress in improving its financial systems, which supply key data for evaluating the financial solvency of properties. However, until these data can be integrated with data on the properties' physical conditions, HUD's oversight of the inventory of assisted properties will continue to be impaired.

Comprehensive Needs Assessments Are Not Being Submitted for Assisted Multifamily Properties

Under the Housing and Community Development Act of 1992, as amended, owners of older, assisted multifamily properties are required to submit comprehensive needs assessments to HUD. Each assessment, which is to be prepared by an entity independent of the owner, must contain a description of the current and future financial or other assistance needed to ensure that the property is well maintained and financially viable. The assessment must also describe any resources available for meeting the current and future

needs of the property and the likelihood of obtaining these resources.

These assessments would provide HUD with useful information for making decisions about how to address any identified problems. Furthermore, HUD is required to use these assessments as the basis for its decisions on assisting physically and financially troubled projects under the Flexible Subsidy and Loan Management Set-Aside programs. According to HUD officials, however, owners are not submitting these comprehensive needs assessments because HUD has not yet issued guidelines or regulations implementing the requirement that they do so.

In addition, HUD has yet to systematically identify those projects with the most severe physical problems. While improved management information systems are critical for the ongoing management of HUD's inventory of assisted properties, and needs assessments are crucial for determining repair costs, current limitations in these data sources do not preclude HUD from systematically identifying those assisted properties that are in the worst physical condition. Simple walk-through inspections by either HUD field office staff or outside inspectors could provide HUD with information on how many properties are in conditions similar to those we discussed at the July 1994 hearing. This information, together with data from the past inspection reports on the properties, would put HUD in a position to (1) systematically notify property owners of the need to address physical problems at the properties and (2) take appropriate enforcement actions when owners do not bring their properties into compliance with housing quality standards.

CONCLUSIONS

Each federally assisted property that has fallen into serious disrepair needs to be analyzed on a case-by-case basis to compare

the cost of rehabilitation and the associated costs of providing rent subsidies that continue after the property is rehabilitated with the cost of providing the tenants with certificates or vouchers. Among the more important factors to be analyzed are the total cost of rehabilitation, market rents in the area in which the property is located, applicable fair market rents, vacancy rates, and the views of tenants and community leaders on what should be done with the property.

Current housing policies have generally supported preserving subsidized housing and have not required HUD to consider housing alternatives. One way of preserving properties like Edgewood Terrace Apartments is through government-supported rents well above local market levels.

As we stated in our earlier testimony, the current budgetary climate requires all federal agencies to consider the cost implications of their policy decisions. Yet in dealing with its portfolio of physically distressed properties, HUD is limited by legislation that precludes it from using funds recaptured from terminated Section 8 contracts to relocate tenants from severely distressed properties to other properties of higher quality. Current laws also limit HUD's discretion to use certificates or vouchers in dealing with physically distressed properties. Providing HUD with greater flexibility in using certificates and vouchers would require congressional action.

In dealing with distressed properties, it is important that HUD balance fiscal responsibility and the interests of affected tenants and communities. We support the provisions of H.R. 5115 that would require these cost implications, along with other factors like the views of tenants and community leaders, to be carefully weighed in HUD's decisions on how to proceed with individual properties. We also support the bill's provision that would authorize the Department to use recaptured Section 8 program

funds to relocate tenants currently living in physically distressed properties by offering them certificates and vouchers. Debate on this bill might also consider broadening the general authority of the Department to use certificates and vouchers as an option in disposing of formerly subsidized properties.

Finally, HUD is limited by the lack of a comprehensive strategy focusing on the properties and by inadequate information systems. As we recommended in our July 1994 testimony, HUD needs to develop such a strategy to address the very poor physical conditions of properties like Edgewood Terrace Apartments and 6000 South Indiana Avenue. We said that as part of this strategy, HUD should, through the use of its field staff or with the help of outside contractors (1) promptly identify all Section 8 assisted properties with severe physical problems and offer affected tenants temporary assistance to relocate to safe and decent housing, (2) systematically notify owners of the problems identified, and (3) take appropriate enforcement actions in cases in which owners do not bring their properties into compliance with housing quality standards. Also, to the extent that budgetary or legislative constraints prevent HUD from addressing these conditions, and limit its options in disposing of physically distressed properties, we recommended that HUD provide the Congress with an assessment of the resources and legislative changes the Department needs.

COST OF FINANCING THE REHABILITATION OF EDGEWOOD
TERRACE APARTMENTS AT FOUR RENT LEVELS

	Market rents	Rents at 85 percent of FMR	Rents at 100 percent of FMR	Rents at 132 percent of FMR
Potential rental income				
Efficiency (20)	\$ 480/mo.	\$ 538/mo.	\$ 633/mo.	\$ 836/mo.
1 bedroom (81)	560/mo.	611/mo.	719/mo.	949/mo.
2 bedroom (76)	660/mo.	717/mo.	844/mo.	1,114/mo.
3 bedroom (43)	760/mo.	977/mo.	1,149/mo.	1,517/mo.
4 bedroom (72)	810/mo.	1,177/mo.	1,385/mo.	1,828/mo.
Yearly income at 100 percent occupancy	\$ 2,353,440	\$ 2,898,534	\$ 3,410,040	\$4,501,253
Calculation of maximum mortgage				
Effective gross income (97 percent occupancy)	2,282,837	2,811,578	3,307,739	4,366,215
Total operating expenses/replacement reserve	(1,500,967)	(1,500,967)	(1,500,967)	(1,500,967)
Net operating income	781,870	1,310,611	1,806,772	2,865,248
Debt financing supported by rent levels (15-year term at interest rate of 9.37 percent)	5,715,252	9,580,203	13,207,002	20,944,171
Calculation of cash subsidy				
Total rehabilitation expense	20,777,608	20,777,608	20,777,608	20,777,608
Debt financing supported by rent levels	5,715,252	9,580,203	13,207,002	20,777,608
Cash investment needed	15,062,356	11,197,405	7,570,606	0

Note: FMR = fair market rent.

VIABILITY OF CERTIFICATES AND VOUCHERS AS AN ALTERNATIVE
TO REHABILITATION IN THE WASHINGTON, D.C., MARKET

To evaluate whether certificates and vouchers are a viable alternative to rehabilitating Edgewood Terrace Apartments, we considered several additional issues. We looked at the vacancy rates in the community to determine whether units are available at or below the fair market rent (FMR). We also considered whether landlords are willing to rent to tenants with certificates and vouchers. Finally, we examined the rents that tenants using certificates and vouchers would likely have to pay to rent units that meet housing quality standards.

According to 1990 Census data, the vacancy rate for units renting at or below the FMR was about 8 percent in Washington, D.C., and 11 percent for the Washington, D.C., metropolitan statistical area. We were unable to obtain other statistically reliable data to update these figures.

In examining whether landlords are willing to rent to tenants with this type of assistance, we contacted the Department of Public and Assisted Housing in Washington, D.C., in an attempt to get an indication of whether such families are experiencing difficulty in locating rental housing. This Department, which administers the city's certificate and voucher programs, did not respond to our request for information. Nevertheless, we note that several thousand families in Washington, D.C., are successfully using certificates and vouchers. In addition, the willingness of landlords to accept tenants with such assistance was the subject of a study commissioned by the National Multifamily Housing Council.¹⁰ The Council's final report concluded that several fundamental

¹⁰Final Report on Recommendations on Ways to Make the Section 8 Program More Acceptable in the Private Rental Market, Abt Associates, Inc. (Cambridge, Mass: Mar. 1994).

APPENDIX II

APPENDIX II

changes to the requirements and regulations of the certificate and voucher programs could significantly increase private owners' participation. These changes focused on increasing the accountability and responsibility of the housing authorities that administer the program, the owners who rent units under the program, and the residents who live in the Section 8 units, while still maintaining the program's goals of providing affordable, good quality housing to low-income families. We recognize that, even if these changes are made, families can still experience difficulty in finding affordable rental housing in specific neighborhoods.

As noted in the body of our testimony, if tenants at Edgewood Terrace Apartments were provided with certificates or vouchers and chose to relocate in more expensive neighborhoods, either at 85 percent of the FMR or at 100 percent of the FMR, the costs of this assistance could be significantly less than the costs of rehabilitating the property.

(385441)

Mr. PETERSON. Thank you very much. We appreciate your being with us.

Finally, Secretary Retsinas, we appreciate you being with us. We know you have a tough job. We don't mean to pick on you. We are glad to have you back with us today. We look forward to your testimony.

STATEMENT OF NICOLAS P. RETSINAS, ASSISTANT SECRETARY, HOUSING, FEDERAL HOUSING COMMISSION, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, ACCOMPANIED BY HELEN DUNLAP, DEPUTY ASSISTANT SECRETARY FOR MULTIFAMILY HOUSING

Mr. RETSINAS. Thank you, Mr. Chairman and members of the committee. Thank you for this opportunity.

I welcome, Mr. Chairman, your opening statement where you said you were interested in constructive solutions. This has been a problem, as you have all pointed out, that has been in the making a long, longtime, and we need to be about the business of fixing it. We need to be about that business as constructively as possible.

I appreciate the focus on this problem. It is one that merits the focus. There have been times when I have felt like a lone voice in the wilderness. When I joined this administration last spring, my first appearance was before your colleagues on the banking committee. In that appearance, I proposed legislation that would give us substantial relief and flexibility from the restrictions that were imposed by this Congress on the multifamily property disposition program.

A bill emerged 10 months later that met some of those goals, but still did not give us the flexibility that we sought and that we do need, as Ms. England-Joseph and Ms. Gaffney indicated.

Further, I regret to inform you, but in the spirit of candor which I know you would wish, this year, this past week, we learned that our reauthorization, the Housing Act of 1994, was not to be. In that bill, in that bill were provisions that would give us more flexibility, give us the opportunity to say no to certain Section 8 contract renewals. But now we will not have that flexibility.

So I am pleased we are going to focus, and I hope this bears fruit in the future in terms of the same spirit that you and members of the committee have in terms of giving us that flexibility, is passed on to your colleagues as relates to this.

As I said when I testified here in July, Mr. Chairman, it is totally unacceptable to us in the department that anyone should be forced to live in substandard conditions in federally subsidized housing. And it is equally unacceptable that taxpayers should be saddled with the burden of subsidizing substandard properties.

Furthermore, as I said, it is completely intolerable to us that the deteriorating federally assisted housing developments are literally endangering whole neighborhoods and communities.

Our mission is not only housing, but helping to build stronger communities. That increases our sense of urgency about cleaning up the assisted housing mess.

Mr. Chairman, while we and this administration inherited this mess, I am not going to waste your time today by assessing blame. At this stage of the game, blame is beside the point. All that mat-

ters now is that we do everything we can to repair the damage and make all of our assisted housing work for residents, for taxpayers and for communities.

Last month you sent me a letter in which you posed a series of very thoughtful questions. I brought the answers with me and I submit them for the record for you and your colleagues. But since time is limited and the questions somewhat technical and the responses detailed, I would like to submit my answers separately for the record. Of course, I will be happy to elaborate in the question and answer period.

Mr. Chairman, there is no denying that much too much of our Section 8 assisted housing is in serious trouble. And the question facing us today is twofold. First, is it worth the effort and expense to turn this housing around? Second, if it is, how do we do it?

In answer to the first question, we simply do not walk away from the residents in troubled assisted housing. The neighborhoods surrounding these troubled housing are often in trouble themselves.

If we walk away from this housing, we also walk away from the communities. We contribute to their decline. We leave them at greater risk than they already are.

Because, Mr. Chairman, if we are not willing to clean up the mess we helped make, who will? Who will take the risk in investing in a deteriorating community when there is so much competition for investment from other places which hold more immediate promise?

We have a responsibility to turn these developments around, not only for their own sake but for the communities' sake. We cannot and must not view them in isolation, as a building here and a building there. We must see them as part of larger communities, and we must understand that by turning them around, making them work better, we help communities work better.

There is another reason we cannot walk away from these troubled developments: the people who live there. The majority are people who are trying to raise families and make ends meet. They live in assisted housing simply because they do not earn enough to afford market rents.

I think it is fair to say many of these residents, working people with children, could end up in homeless shelters and on the streets if we walk away. At a time when 600,000 Americans are homeless, the last thing we want to do is put more people on the streets.

Finally, Mr. Chairman, who ultimately pays the price for deteriorating communities and increased hopelessness? The taxpayers. They pay the bill for public safety and public health and for welfare and unemployment. When communities decay, economies decline, jobs disappear, and people wind up on the streets. So we cannot walk away from all assisted housing developments. We must turn them around and make them work, for communities, for residents, and for taxpayers.

This, however, does not mean we need to turn around all assisted housing developments. There will be projects that we must and should provide tenants with vouchers to relocate elsewhere.

When I was here in July, I outlined a four-point comprehensive strategy for addressing the needs of troubled assisted housing. This

is built on enforcement, repair, resident responsibility and changing the way we do business at HUD.

I would like to take a few moments this morning to highlight some of the key things we have done to advance the strategy since your last hearing in July. Then I would like to talk about the legislative changes that I personally believe should be considered in order to build on this progress.

In July I said we would establish SWAT teams to restore these projects to physical and financial health. We have now taken this plan from the drawing board to reality. Within the next 2 weeks, 24 of our most knowledgeable and capable professionals will be brought together here for training and orientation. After that week-long session, they will immediately deploy to severely distressed assisted housing developments in key communities to replace ineffective management, find new owners where necessary, repair properties, and engage residents and local communities and various community groups in the future of these developments.

Our field staff and the Inspector General's office have already identified 90 projects for SWAT team attention. One of our goals is to start restoring approximately 100 properties in the first year. In many cases it will take many years to fully turn these properties around. However, in the next 6 to 12 months you will see dramatic improvements to these properties. I encourage your participation in that effort.

When I last came here I said we would engage residents, and we are doing that. Last week in Denver, under our new safe neighborhood action plan initiative, residents of assisted housing met with assisted housing owners and managers, local government officials, HUD staff and officials from the Justice Department and other agencies to discuss ways to deal with crime and security in assisted housing neighborhoods and to map out strategy to turn the assisted housing communities around.

For the first time HUD is bringing local officials, law enforcement, owners and managers, and residents together to deal with crime and other social issues in assisted housing communities. In various cities like Detroit, Denver, Boston and Columbus, grassroots strategies are emerging.

Mr. Chairman, we will once again ask residents to be part of the solution of turning communities around. I am also pleased to announce this morning that the department has made significant progress in permitting special rent increases to fund service coordinators in certain assisted properties. Service coordinators will link residents with use services, counseling, training, and other services which will help them to lift themselves to better lives.

When I testified in July I said we would change the way we do business. I am pleased to report today that last week we reassigned 87 performing multifamily mortgages to Fannie Mae. By that one action we reduced our HUD-held portfolio by 8 percent, freeing our staff to focus on the early warning and loss mitigation of potentially troubled properties.

This is just a start. We have announced two additional sales to the private sector which will total approximately 300 mortgages. This is good business for HUD.

Mr. Chairman, all these accomplishments I have just mentioned are tangible evidence that HUD and FHA are starting to work. We are working better for the American people, we are making assisted housing work better. However, I think it is important to focus on real projects, real communities, and real people.

I would like to tell you about Germano-Millgate, a 22-year-old assisted housing development on the South Side of Chicago. It originally served a mixed income population. But the closure of a nearby steel plant decimated the community economically and the development's residents became increasingly lower income. It slipped into neglect and decay.

HUD, with the help of the Illinois Housing Development Authority, brought a severely delinquent mortgage current, preventing a foreclosure. At the same time, 350 units were completely rehabilitated. We did more than simply save the mortgage and rehabilitate the structure. A daycare center was established, as well as an after-school learning center, a summer work program for the youth. The seven units not rehabilitated were gutted and transformed into a community meeting center. All the funding for these programs have been provided by the new private owners.

Trenton Park here in Washington, DC, a HUD-owned, 259-unit development was once a severe threat to an otherwise decent residential neighborhood. HUD set aside units in affordable market rates for middle-income renters and subsidized the balance of the units to restore Trenton Park as a mixed-income development. We also established an aggressive resident ownership training program and a daycare center. In addition, we sought to maximize employment opportunities for residents in both the rehabilitation and management of the property.

More significantly, the community, not HUD, made a commitment to assist market rate residents who could no longer meet their rent obligations. This creative alternative to the more traditional approach of rehabilitation with 100 percent subsidy support required innovative ideas from the private sector and a willingness by HUD to accept them and work to achieve an effective compromise solution within the severe limitations of the disposition statute.

We can be proud of what we have accomplished so far, but I would be the first to admit it is just a start. There are some additional critical statutory changes I personally believe we should consider to build on the work we have begun to make assisted housing work for communities, residents, and taxpayers.

First, I believe we need more funding flexibility. If we are really going to make headway, we have to be able to spend our limited dollars smarter. Our current flexible subsidy programs are too narrowly focused. It is just not simple enough to address the physical, financial, and social problems of assisted housing.

Consolidating the flexible subsidy program with other resources would enable FHA to address financial issues, physical problems, drug and crime prevention, support services for residents and other needs in a timely and expeditious manner.

Second, I believe we must modify our preference rule to bring assisted housing into conformance with public housing. Preferences in assisted housing must apply to no more than half of the vacant

units instead of the 70 percent under the preference rule now. Without this change, we will continue to concentrate very low-income families in assisted housing. Experience has proven this is unhealthy, both for residents and surrounding communities.

Third, I believe we must change the way rents are adjusted. Current rent calculation formulas do not consistently set rents for the amounts the property requires. Some collect more than they need. Others don't collect enough.

We need to be able to switch at our discretion between the annual adjustment factor and the budget-based methodology in evaluating rent increases for these Section 8 projects. This will help avert cash-flow inconsistencies. We also need to be able to decrease rents where they are excessive.

Finally, I want to mention the possibility of forgiving a portion of the tax liability accruing on the capital gains realized when a partnership transfers a project. While this is something I personally favor, any such proposal must be considered in the broader context of overall tax policy.

While the administration does not support it at this time, we continue to consult with Treasury on the impact and feasibility of this tax reform.

Mr. Chairman, I know we are all in agreement on the critical need to do this. I want to thank you for your constructive legislative proposals. I believe it provides a base for us to begin to work together and think through how we want to balance our flexibility with what are very legitimate public policy objectives.

I am particularly interested in your proposal to support the repeal and prohibition of lowering Section 8 rents, the improvements on the comparability reviews and the recapture of Section 8 project-based funds.

Mr. Chairman and members of this committee, I want to thank you again for the opportunity to address you today. I know we all share the same goal: making assisted housing work the way Congress intended it to work for residents, communities and taxpayers. And I look forward to working with you and this committee to see that it does.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Retsinas follows:]

STATEMENT BEFORE
THE HOUSE COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON
EMPLOYMENT, HOUSING AND AVIATION

OCTOBER 6, 1994



By
NICOLAS P. RETSINAS
ASSISTANT SECRETARY FOR HOUSING
FEDERAL HOUSING COMMISSIONER

Statement of
Nicolas P. Retsinas
Assistant Secretary for Housing/Federal Housing Commissioner
before the
Committee on Government Operations
Subcommittee on Employment, Housing and Aviation
United States House of Representatives
October 6, 1994

Mr. Chairman and members of the committee:

Thank you for inviting me back here today to update the committee on what HUD is doing to identify troubled assisted-housing, and what we're doing to preserve and dispose of this troubled housing.

Mr. Chairman, we appreciate and share your concern about the physical and financial condition of the estimated 400,000 units of Section 8 assisted housing that are seriously at risk today. These 400,000 units represent 20 percent of HUD's 2 million-unit assisted-housing inventory, and in our view, that is 20 percent too much.

As I said when I testified here in July, Mr. Chairman, it is totally unacceptable to us that anyone should be forced to live in substandard conditions in federally subsidized housing, and it is equally unacceptable that taxpayers should be saddled with the burden of subsidizing substandard properties.

Furthermore, as I said in July, it is completely intolerable to us at HUD that deteriorating federally assisted housing developments are literally endangering whole neighborhoods and communities. Our mission is not only housing, but helping to build stronger communities, and that increases our sense of urgency about cleaning up the assisted-housing mess.

Mr. Chairman, though we in this administration inherited this mess, I am not going to waste your time today by trying to assess blame. At this stage of the game, blame is beside the point. All that matters now is that we do everything we can to repair the damage and make all of our assisted housing work for residents, taxpayers, and communities.

In this, as in so many other matters, that's what we were sent here to do: make things work for ordinary people. Mr. Chairman and members of this committee, I know this is your goal as well.

Mr. Chairman, last month, you sent me a letter in which you posed a series of very thoughtful questions. I've brought the answers with me. But since time is limited, and since

the questions are somewhat technical and the responses are detailed, I would like to submit my answers separately for the record. Of course, I will be happy to respond to these and any other questions you might have following my statement.

Mr. Chairman, as I've just said, there is no denying that much too much of our Section 8 assisted housing is in serious trouble. And the question facing us today is twofold:

First: Is it worth the effort and expense to turn this housing around?

And, second: If it is, how do we do it?

Mr. Chairman, in answer to the first question, we simply cannot walk away from the residents in troubled assisted housing.

The neighborhoods surrounding this troubled housing are often in trouble themselves. If we walk away from this housing, we also walk away from these communities. We contribute to their decline. We leave them at greater risk than they already are.

Because, Mr. Chairman, if we are not willing to clean up the mess we've helped make, who will? Who is going to take the risk of investing in a deteriorating community, when there is so much competition for investment from other places which hold more immediate promise?

We have a responsibility to turn these developments around, not only for their own sake, but for the communities' sake. We cannot view them in isolation -- as a building here and a building there. We must see them as part of communities, and we must understand that by turning them around, making them work better, we help communities work better.

There is another reason we cannot walk away from all troubled developments, Mr. Chairman: the people who live there.

The overwhelming majority of assisted-housing residents are working people who are trying to raise families and make ends meet. They live in assisted housing because they don't earn enough to afford market rents.

Mr. Chairman, I think it's fair to say that many of these residents -- working people with children -- will end up in homeless shelters or on the streets if we walk away from all this housing. And at a time when 600,000 Americans are already homeless, the last thing we want to do is catapult more people into the streets.

And finally, Mr. Chairman, who is it who ultimately pays the price for deteriorating communities and increased homelessness? The taxpayers. They pay the bill for public safety and public health -- and for welfare and unemployment -- when communities decay, and economies decline, and jobs disappear, and people wind up on the streets.

So we cannot walk away from all assisted-housing developments. We must turn them around; we must make them work. We must make them work for communities, for residents, and for taxpayers. This, however, does not mean we need to turn around all assisted-housing developments. There may be projects that we must and should provide tenants with vouchers to relocate elsewhere.

Mr. Chairman, when I was here in July, I outlined a four-point strategy for addressing the needs of troubled assisted housing. This strategy is built on enforcement, repair, resident responsibility, and changing the way we do business at HUD.

I'd like to take a few moments to highlight some of the key things we have done to advance this strategy since your last hearing in July, and then I would like to talk about the legislative changes that I personally believe should be considered in order to build on this progress.

When I testified in July, I said we were going to establish "SWAT" teams to restore several score of severely troubled projects to physical and financial health.

We have taken this plan from the drawing board -- where it was in July -- to reality.

In 18 days, 24 of our most knowledgeable, capable professionals -- who have committed an entire year to this effort -- will be brought together here in Washington for training and orientation. And after that week-long session, they will immediately deploy to severely distressed assisted housing developments in key communities -- to replace ineffective management, find new owners where necessary, repair properties, and engage residents, local government and various community groups in the future of these developments. Our field staff and the IG's office have already identified 90 projects for SWAT team attention. One of our goals is to start restoring approximately 100 properties in the first year. In many cases, it will take years to fully turn these distressed properties around. However, I can assure you that, within next 6 to 12 months, you will see dramatic improvements to these properties.

I said we would move quickly on this, and we have.

When I last came here, I said we would engage residents, and we are doing that.

Last week in Denver, under our new Safe Neighborhood Action Plan (SNAP) initiative, residents of assisted housing met with assisted housing owners and managers, local government officials, HUD staff, and officials from the Justice Department, the HUD Inspector General's office and other agencies to discuss ways to deal with crime and security in assisted housing neighborhoods and to map out strategy to turn the assisted housing communities around.

For the first time, HUD is bringing local officials, law enforcement, owners and managers, and residents together to deal with crime and other social issues in assisted-housing communities. In various cities, like Detroit, Denver, Boston, and Columbus, grassroots strategies are emerging. Mr. Chairman, we will once again ask residents to be part of the solution -- turning communities around.

Mr. Chairman, I am pleased to announce that the Department has made significant progress in permitting special rent increases to fund service coordinators in certain assisted properties. This notice will be issued in the near future. These coordinators will link residents with youth services, parenting skills classes, counseling, training and other services which will help them to lift themselves to better lives.

When I testified in July, Mr. Chairman, I said we were changing the way we do business. I am pleased to be able to report today that last week we reassigned 87 performing multifamily mortgages to Fannie Mae. In one week, Mr. Chairman, we reduced our HUD-held portfolio by 8 percent, freeing our staff to focus on the early warning and loss mitigation of potentially troubled properties. This is just a start. We have announced two additional sales, which will total approximately 300 mortgages. This is good business for HUD.

Mr. Chairman, all these accomplishments I've just mentioned are tangible evidence that HUD and FHA are changing. We're working better for the American people; we're making assisted housing work better.

I'd like to take just a moment to tell you what this means for actual residents and communities.

Germano-Milgate

First, Mr. Chairman, I'd like to tell you about Germano-Milgate, a 22-year-old assisted-housing development on the South Side of Chicago. Germano-Milgate originally served a mixed-income population, but the closure of a nearby steel plant decimated the community economically and the development's residents became increasingly lower income. It slipped into neglect and decay.

At Germano-Milgate, HUD, with the help of the Illinois Housing Development Authority, brought a severely delinquent mortgage current -- averting a costly and disruptive foreclosure. At the same time, 350 of the development's 357 units were completely rehabilitated, with complete occupancy scheduled for this December.

We did more than simply save the mortgage and rehabilitate the structure. A day care center was established, as was an after-school learning center for children age 9-12, and a summer work program exclusively for Germano-Milgate youth. The seven units that were not rehabilitated were gutted and transformed into a community center and meeting hall for

the newly formed residents' association. All the funding for these programs has been provided by the new, private owners.

Germano-Milgate is now a community asset instead of a liability. It's working.

Trenton Park

We've made assisted housing work in here in Southeast Washington, Mr. Chairman. It's now working at Trenton Park, a HUD-owned, 259-unit development, which was once a severe threat to an otherwise decent residential neighborhood.

To turn Trenton Park and the community around, HUD set aside units at affordable market rates for middle-income renters, and subsidized the balance of the units -- to restore Trenton Park as a mixed-income development.

We also established an aggressive resident ownership training program and a day care center. In addition, we sought to maximize employment opportunities for residents in both the rehabilitation and management of the property. More significantly, the community, not HUD, made a commitment to assist market-rate residents who could no longer meet their rent obligations, through an Emergency Rent Fund.

This creative alternative to the more traditional approach of rehabilitation and 100-percent subsidy support required innovative ideas from the private sector and a willingness by HUD to accept them and work to achieve an effective compromise solution within the limitations of the disposition statute.

Mr. Chairman, we can be proud of what we've accomplished so far, but it's just a start.

There are some critical statutory changes that I personally believe we should consider to build on the work we've begun and to really make assisted housing work for communities, residents and taxpayers.

First: I believe we need more funding flexibility. If we're really going to make headway, we've got to be able to spend our dollars smarter. Our current flexible subsidy program is too narrowly focused; it's not supple enough to address the physical, financial and social problems of assisted housing.

Consolidating the Flexible Subsidy program with other resources would enable FHA to address financial issues, physical problems, drug and crime prevention, support services for residents, and other needs in a timely and expeditious manner.

Second: I believe we must modify our preference rule to bring assisted housing into conformance with public housing. Preferences in assisted housing must apply to no more than half of vacant units, instead of the 70 percent which are under the preference rule now.

Without this change, we will continue to concentrate very-low-income families in assisted housing, and experience has proven that this is unhealthy, both for residents and surrounding communities.

Third: I believe we must change the way rents are adjusted. Current rent-calculation formulas do not consistently set rents at the amount a project requires. Some properties collect more than they need. Others do not receive enough rent to operate successfully. We need to be able to switch at our discretion between the annual adjustment factor and the budget-based methodology in evaluating annual rent increases for Section 8 New Construction and Substantial Rehabilitation projects. This will help avert cash-flow deficiencies in assisted projects where unusually difficult management problems occur. We also need to be able to decrease rents where they are excessive.

Finally, I want to mention the possibility of forgiving a portion of the tax liability accruing on the capital gains realized when a partnership transfers a project. While this is something I personally favor, any such proposal must be considered in the broader context of overall tax policy. While the Administration does not support exit tax reform at this time, the Department continues to consult with Treasury on the feasibility and impact of exit tax reform.

Mr. Chairman, these changes could enhance our ability to address the needs of troubled assisted housing. And I know we're all in agreement on the critical need to do this.

I would like to thank you, Mr. Chairman, for the legislation you recently introduced -- the Section 8 Project-Based Program Management and Improvement Act, H.R. 5115. Your support for the repeal of the prohibition on lowering Section 8 rents, improved comparability reviews, and the recapture of Section 8 project-based funds for reuse as vouchers or certificates when properties are foreclosed is especially appreciated.

Mr. Chairman and members of this committee, I want to thank you again for the opportunity to address you today. I know we all share the same goal -- making assisted housing work the way Congress intended it to work for residents, communities and taxpayers -- and I look forward to working with you and this committee to see that it does.

Thank you.

ADDENDUM TO THE TESTIMONY OF

NICOLAS P. RETSINAS
 ASSISTANT SECRETARY FOR HOUSING - FEDERAL HOUSING
 COMMISSIONER

before the

COMMITTEE ON GOVERNMENT OPERATIONS
 SUBCOMMITTEE ON EMPLOYMENT, HOUSING AND AVIATION
 UNITED STATES HOUSE OF REPRESENTATIVES

October 6, 1994

1. What steps has HUD taken to identify its troubled projects?

The Department is taking steps to refine existing tools and introduce new tools to enhance our system for identifying our troubled properties. We have also contracted with outside experts in the financial areas to help us identify problem projects. Since many of our systems are either new or in its early stage of implementation, it is difficult to gauge its overall effectiveness at this time. However, one thing is clear -- more reviews need to be done, and I am working to see this occurs.

Identification tools that the Department has now are:

o Financial Statement Analysis Contract

Another effort has been to enter into a contract for the analysis of financial statements submitted by owners of all properties, whether troubled or non-troubled. An outgrowth of these efforts is the development of an early warning system which would provide field offices with information of the property's physical and financial health at a time when steps can be taken to correct the problems before a claim is filed against the insurance fund.

o Capital Needs Assessments

Specifically, HUD has contracted for physical inspections of insured non-troubled properties, thereby freeing up field office staff time to focus on the physical conditions in the troubled portion of the inventory, including the identification of problems and the development of a plan to cure the deficiencies.

o Comprehensive Multifamily Servicing Program

This provides indices to help identify specific troubled properties, to determine the extent to which troubled properties affect the total inventory, and to lay out a course of action to be taken once troubled multifamily properties are identified. This program shows good potential for helping us cure problems before they escalate. However, implementation has not been as fast or as extensive as we would like. Resource constraints are affecting our ability to subject a large number of projects to comprehensive multifamily servicing. Field staff are using this tool to the extent resources and expertise are available.

The department has taken a more aggressive approach to the servicing of troubled properties by attempting to delve further into the root causes of the problems leading to designation as troubled. We find that this is important to resolving our universe of identified troubled properties, as well as providing early warning indicators for conditions which can lead to troubled property designations quickly.

2. Is HUD performing a financial analysis to determine what actions to take on its troubled projects? A financial analysis would include the following information for each project: 1) factual information, 2) financial information, 3) an assessment of the social impact of each option HUD could take, and 4) a comparison of options HUD could take (see Attachment for details on the content of the financial analysis). Specifically, what are the elements of the financial analysis that HUD is currently performing? Please be prepared to present a recent financial analysis of a troubled project at the hearing.
3. Is HUD performing a financial analysis of each troubled project?

As we continue to stress, HUD's comprehensive monitoring and enforcement strategies are still in their infancy. The kinds of financial analysis that the question suggests are still beyond the Department's reach. For example, the annual financial statement and on site physical inspections and management reviews collect the kinds of factual information necessary to assess the extent of physical and financial distress. However, arraying options which would include choices to abandon the property by giving all tenants portable subsidies, or acquiring and demolishing the property have not been included in the Department's decision making strategies. This is partly because the Department's stated goals have emphasized the preservation of the housing stock.

The financial statement contract has played an important role in the analysis of the troubled inventory, however, it does not replace the important function the loan servicer plays in this process. While this analysis can present key ratios which indicate the fiscal health of a property, it does not tell the whole story. HUD will now conduct a financial statement analysis on every property in the HUD inventory, however, the ability to conduct an in-depth analysis, beyond the ratios, where the root of the problems are often revealed is highly dependant upon adequate staff with the training and resources to analyze the projects.

A good example of the limitations of relying on financial statement analysis alone as a warning of trouble is the Holiday Lake project in Pompano Beach, Florida. While this project was in very poor physical condition, the financial statements did not give field office staff an indication of the severity of the problems. It took a Legal Aid threat to sue the owner to alert the field office to the troubled nature of the property.

It is clear that a simple financial analysis often does not determine what actions need to be taken to resolve the problems of a troubled property. Rather it takes the skills of a capable loan servicer, with the time and ability to look beyond the numbers to find the root of the problems. In some instances they may be physical, financial, social or, as in most cases, it is a combination of the three.

4. **When the information is collected, does HUD have a process to make a decision on actions to take on troubled projects?**

The Department's procedures for assessing and acting on troubled projects have long been codified in handbook instructions to its field offices. These instructions include methods for reinstating the mortgage, effecting required repairs and preparing to foreclose on the property. A key part of this assessment is the Least Cost Analysis. this assists the loan servicer in deciding which course of action, both financially and socially is in the best interest of HUD. In many cases the answer is foreclosure. For the other cases the Department works with the owner of the property to craft a rehabilitation and mortgage reinstatement plan, which may or may not include additional Federal assistance. In those instances where owners cannot or do not cooperate or where a sale cannot be effected, the Department's sole option is foreclosure.

5. **When HUD provides additional funds to a troubled project through Loan Management Set Aside, Flexible Subsidy, or special rent increases, what type of assessment does HUD perform to determine which properties will receive additional funding and the funding amount? Please describe this assessment.**

LMSA

HUD field offices are required to review the projects' current audited financial statements, budget, project payment histories and tenant profiled prior to consideration for LMSA funding. This process is necessary to evaluate appropriateness and project need for the addition of section 8 funding. The project and its ownership are then subjected to an intense review before an award is made. Since funds are limited, projects must compete for them against other projects. Until recently, funding competitions were conducted on a national basis. In 1994, funds were allocated to HUD's regional jurisdictions and funding decisions were delegated to the regional directors of Housing. Programmatic criteria consisting of requirements such as owner compliance with the regulatory agreement, and certification that the problems of the project are not caused by the owner, as well as housing quality standards adherence, must be met prior to the receipt of funds under this program. The number of units to be awarded are calculated based on the minimum number necessary to resolve the problems in the project.

FLEXIBLE SUBSIDY

The order of funding for flexible subsidy mandated by statute has, until this year, required the funding of insured properties over all other applicants. In addition, HUD regulations provide for preference to be given in emergency repairs and then to troubled properties. Therefore, after a property is determined to be eligible for assistance under the program types listed in the statute, the priority for funding is determined first based on whether or not they are HUD insured and next based on the emergency health and safety needs outlined in the MIO Plan as well as whether or not they are defined as troubled by the HUD field office.

SPECIAL RENT INCREASES

In May, 1994, the department issued a notice establishing the requirements and procedures for processing special rent increases for non-drug related crime prevention activities for properties whose rents are adjusted using the annual adjustment factor (AAF). This action enables properties to receive additional financial assistance to develop means of dealing with such activities on-site. The down-side is that additional funding to deal with crime-related activity must come from the existing funding for amendments, a limited funding source. An additional notice providing for similar adjustments for service coordinators is nearing completion and should be published shortly.

6. What options does HUD have for disposition of troubled projects under the current property disposition laws? Describe any statutory impediments to the disposition of troubled projects, and any legislative

changes on property disposition needed to assist HUD in taking action on troubled projects.

The department's ability to foreclose on multifamily properties and dispose of them in the most cost effective manner is indeed an important activity, although further streamlining the department's property disposition practices alone is not the panacea in addressing the issues of housing quality standards in section 8 assisted properties.

Foreclosure is one component of a larger enforcement strategy, one which needs to be enlarged and enhanced if the department is going to realistically address the difficult area of housing quality. A number of additional components were in the authorization bills which failed to reach conference:

- o Expansion of civil money penalties, as proposed in the Senate bill, to include identity of interest managing agents and for any owner who violates a provision of the section 8 contract.*
- o Expansion of capital needs assessment authority to all section 8 properties, especially in advance of the contract expiration and potential renewal.*
- o The ability to reuse section 8 subsidy funds recaptured from projects whose owners have been subject to enforcement actions.*

Finally, there is the issue of acquiring and disposing of properties, for which there is no prospect of working out the physical and financial difficulties of a project without resorting to foreclosure.

Some background on the development of the Multifamily Property Disposition Reform Act of 1994 is necessary. When this administration assumed control of the department, the HUD owned inventory, and the cost of selling it under existing law was identified as one of the top issues for HUD. Imbedded in that problem was the concern that the law might be requiring us to preserve property that should be torn down or converted to other uses including market rate housing.

In refining the original submission to congress, office of Housing officials consulted with residents, community groups and advocates, such as the National Housing Law Project, and repeatedly heard concern about granting HUD flexibility in this area. Frankly, given some of the history of HUD, people worried that HUD would not make reasonable judgments, especially when funds are scarce, and that units would be lost to the affordable housing inventory.

HUD sent up a bill which we felt balanced the needs and resources in a responsible way, and granted HUD additional discretion in several important areas. Over a six month period, we negotiated several issues that balanced HUD's need for flexibility with the concern for preserving units and protecting tenants. The department understands and accepts that the legislation obtained was the best product of that process. In response to your question, however, HUD has identified a number of areas where negotiations produced compromise language.

HUD's original proposal was to use five year section 8 subsidies for "unsubsidized" properties. This would have netted short term budget savings, allowing section 8 dollars to go farther. The enacted law provides for a 15 year term, with a lesser term only when tenants pay section 8 rents for 15 years. This means that if HUD attempted to maximize budget authority by entering into shorter term contracts, it could only do so by guaranteeing the tenants low rents without guaranteeing the subsidy to the purchaser. It is essentially an unworkable option.

HUD's proposal would have generated "mandatory" savings, and used them for grants to state and local governments, or their designee, who would take ownership of HUD properties. This would have augmented HUD staff resources by transferring property to these entities with the resources for rehabilitation. The enacted law provides for grants on an individual project basis from appropriated section 8 funds and subjects them to outlay caps. Further, the appropriations committees have rejected the mandatory savings approach.

HUD's proposal would have allowed up to 10 percent of the units in the subsidized inventory of owned property annually to be converted to tenant-based assistance. The enacted law limited this to 10 percent of sales in a given year. This results in significant reduction in the flexibility to use this tool, and links it to appropriations of 15 year subsidy for 90 percent of sales. HUD's proposal would have created a mandatory program to subsidize the sale of HUD-owned and HUD-held properties. The enacted law did not include this proposal.

HUD's proposal would have sold unsubsidized property either with discretionary tenant-based assistance in the case of hardship or without assistance. The enacted law provides a two year rent freeze for all very low income residents who would pay more than 30 percent of their income for rent. This will involve some administrative burden and impact some on our price.

The Department is generally satisfied with the language in the existing law, and now wants a chance to demonstrate the usefulness of the flexibility granted before asking for additional tools.

7. Provide an update of HUD's 4-point plan outlined at the Subcommittee's July 26, 1994 hearing, and include a description of the purpose and activities of the SWAT Teams. Also provide a status report on the conditions of the ten properties included in the GAO testimony.

A. ENFORCEMENT

I need to emphasize that the last three of the initiatives below, that were introduced during my last testimony, are still in their infancy. It will be some time before they are fully effective and can produce measurable results. Further, and I cannot emphasize this too much, Mr. Chairman, effectively implementing these initiatives is reliant on a fully functioning infrastructure--one that is not fully reorganized. However, changing the Department's priorities, from rote protection of the insurance fund to ensuring the habitability of assisted housing, is a long term effort, attempting to undo a decade's worth of misdirection and neglect.

- o *The Department continues to aggressively pursue **Civil Money Penalties** and enthusiastically endorses their extension to managing agents and Section 8 contracts, as provided in the Senate authorization bill.*
- o *As of October 1 of this year, almost 90% of the 1993 **Annual Financial Statements** will have been reviewed, an increase of over 25% from last year.*
- o *The **Coinsurance Asset Management Contract** continues to be an effective tool in ferreting out equity skimming.*
- o *Contracted **Physical Inspections** continue to be a high priority especially where there are indications that Section 8 units do not meet Housing Quality Standards.*

B. REPAIR THE INVENTORY - THE SWAT TEAM

The most dramatic of the steps we have taken since July is the formation of SWAT teams within FHA to examine the inventory and identify troubled projects.

The SWAT approach provides a concentrated focus of skills and enforcement to prevent the failure of projects (assignment and claim payment) and to mitigate losses to the government. The goals of this effort are to:

- *Reduce loss/risk to the FHA insurance fund.*

- *Signal owners and manager that HUD is serious about enforcing program compliance.*
- *Significant improvement in the physical and financial conditions of the targeted projects.*
- *Identify ways that SWAT and Operation Safe Home can work together.*
- *Develop models for improving the department's ability to cure troubled project conditions and to take appropriate enforcement actions.*

Additional SWAT material are attached.

C. RESIDENTS -- THEIR ROLE AND RESPONSIBILITY

A notice will be issued shortly which will permit special rent increases to fund service coordinators in federally assisted properties whose rents are adjusted using the AAF. This funding will enable property owners/managers to hire service coordinators to identify and coordinate programs for residents ranging from teen and youth activities, housekeeping and parenting skills, and counseling and training.

D. TRANSFORMATION -- CHANGING THE WAY HUD DOES BUSINESS

- o *Two small **Multifamily Notes Sales** will be held later this month. A larger sale is scheduled for February 1995.*
- o *As I mentioned on July 26, the **Housing Technician Program** has recently graduated 57 thoroughly trained field personnel. This intensive, three-year program was designed to relegate routine loan servicing tasks to high trained technical staff so that experienced asset managers can focus their time and energy on the sort of intensive and specific activities that troubled projects require. The positive impact of the Housing Technician Program is already being felt, enabling field personnel to be tapped for the SWAT teams.*
- o *Our **Field Reorganization** is in its final stages of implementation. Since its purpose is to allocate decision making authority at the lowest practicable level, it is designed to reverse another unfortunate tendency of the last decade: the notion that field offices cannot make tough decisions; that those decisions must be made in a bottle-necked headquarters.*

Ms. Dunlap's staff last month completed the awesome task of screening and interviewing the 362 applicants for the 51 key multifamily management positions in our field offices. I have forwarded my nominations for those positions to the Secretary. The selections will be announced by the end of this month.

As I stated in my July testimony, I feel strongly that this new organization will be better suited to address the tasks this subcommittee is concerned with: inspection, enforcement and a bottom line emphasis on quality housing.

Mr. PETERSON. Thank you.

We are, as I said, under significant time constraint. We need to get to the next panel by 10:15 a.m. And there are more members here than I expected. I don't know how many of you have burning questions. Any questions that you have, you can submit to the panel in writing, and they will answer them, I am sure.

I am going to limit you to maybe two questions, if you can get them done in 3 minutes. The rule is that when the bulb goes off, whoever is talking must stop. We will see how this goes. But we are going to be finished by 11 a.m.

Thanks for being here, Mr. Lucas, we appreciate it.

HUD has taken a good first step, as I said, with these SWAT teams.

Mr. RETSINAS. Thank you.

Mr. PETERSON. Did you first identify all of the troubled projects before you chose these hundred? How did you choose these hundred?

Mr. RETSINAS. Let me ask my colleague, Helen Dunlap, who works with this on a daily basis, to focus on the details.

We looked at a number of different data sources in our own records. As you know, we are required and we perform an annual audit and that turned up certain information. We consulted with our field offices. We really put all that information together.

Let me have Helen Dunlap, if I could, Mr. Chairman, walk through the steps we took.

Helen.

Ms. DUNLAP. Our intent in the identification of the projects was to identify them as quickly as possible so that we can begin the process. We used—

Mr. PETERSON. Did you look at all of them?

Ms. DUNLAP. We looked at all the sources we have and developed a list of troubled projects.

Let me tell you what those are. First, we asked the IG for their list of concerns. Second is, we inquired of each field office in the country, and they identified a substantial list. Third, we have a list of troubled projects that we have been developing strategies for in the field offices, approximately 1,400 total. We used that list. Last and most importantly, we went back to the audit for this last year and pulled up the names and specific data on each project in that audit that was identified as substandard or doubtful from a financial standpoint.

We then did a complete analysis of the financial and physical information that we have on those projects so that we could pick the hundred on which we could meet the objectives that we have talked about previously.

Mr. PETERSON. How many projects did you look at?

Ms. DUNLAP. We looked at a total of about 2,400 in our first screening.

Mr. PETERSON. I understand that some people think there may be 6,000 troubled projects.

Ms. England-Joseph, what do you think about what they did? Do you think they looked at everything when they came up with these hundred?

Ms. ENGLAND-JOSEPH. I think they realized the data bases they have are not complete. They may feel that the 2,400 that they focused on may be their worst, but I don't know that anyone has a degree of confidence about the universe.

At the last hearing, I think both the IG and Nic talked about what might be the percentage of this portfolio that is troubled. And I believe you all were talking about the range of 20 to 30 percent of the total inventory.

Mr. RETSINAS. That was financial trouble, right.

Ms. ENGLAND-JOSEPH. Financial has to be the first stage but then you have to go out to visit those properties to determine the physical condition. Did you visit all the financially troubled?

Mr. RETSINAS. That was in the data base.

Ms. DUNLAP. Visiting those properties that we have identified is the first task of the SWAT teams. The key at this point is to get the data to begin the process of evaluation.

Ms. ENGLAND-JOSEPH. Some of the properties we visited when we reported back to you, and I—there were only 10 we looked at, and focused on some of the most troubled we could identify, some of those would not have shown up as financially distressed. So there is a question about the ways in which they have narrowed the scope of their troubled inventory.

Mr. PETERSON. Mr. Secretary, if you are going to deal with 100 of these projects a year, how long will it take you to complete all of them? How many years?

Mr. RETSINAS. We are going to deal with them as quickly and expeditiously as we can. As I indicated last time, the pace of our dealing with these projects is on the one hand affected by the legislative relief, much of which you seek for us, as well as the resources we have.

However, it is a very, very important objective of the SWAT team effort is to change the way we do business. So if we can learn and learn and train ourselves in a better way to do business, the number of projects can increase geometrically. But the pace over time is reflected by resources and flexibility.

Mr. PETERSON. My time is up, but the 100 is just a place to start. You are not locked into 100 projects a year?

Mr. RETSINAS. The key, as Ms. Dunlap indicated, is starting, because we can count and look and study, but starting is the most important thing to do.

Mr. PETERSON. Mr. Zeliff.

Mr. ZELIFF. I don't know if I can do this in three minutes. It is a challenge.

What I am hearing on this side of the table, and I want you to have a chance to respond, is that we have got mismanagement throughout from top to bottom, in HUD, and these programs have been identified back as far as back as 1983, probably even earlier.

And, you know I haven't been there for that whole period of time, so you are trying to make a valiant effort here. I guess what I would like to ask Susan Gaffney and Judy England-Joseph to do is give me your steps, one, two, and three, within current law, first acknowledge or not acknowledge whether mismanagement is the real root of this, and then, if I can, have you follow up, you are talking about SWAT team, but we are dealing with mismanage-

ment, don't we have to start from the top to the bottom? The SWAT team is going to tell you more about what you already know.

Maybe just let's get into the mismanagement end of it, and let's talk about the steps one, two, and three, and maybe can you respond to that.

Ms. GAFFNEY. The mismanagement is years and years of management neglect at HUD. I don't want you to think that I am accusing Helen and Nic of mismanagement. But over a period of years you have to understand that HUD staffing resources have dwindled. They lack expertise in asset management, seriously lack the needed expertise.

Mr. ZELIFF. That also comes into management.

Ms. GAFFNEY. Oh, of course.

Mr. ZELIFF. And accountability.

Ms. GAFFNEY. HUD has, over a period of years, not built data systems to support their actions.

Mr. ZELIFF. Again, that is management.

Ms. GAFFNEY. Of course. The controls within the program are virtually nonexistent. This has been a kind of just business as usual. So we are now in a situation where we can't, they can't manage. It is impossible to manage effectively within this environment. Because they don't have the tools.

So we have to look for some other way to address the immediate situation. But as Nic said and Judy said, this is not just a management problem. There is an enormous program design problem here. And that is a legislative issue.

Mr. ZELIFF. Steps one, two, and three?

Ms. GAFFNEY. Steps one, two, and three—

Mr. ZELIFF. Within existing law. Or is it the law we can blame?

Ms. GAFFNEY. No, first of all, the SWATs are a good idea. I would hate not to support SWATs, because I think my colleagues at HUD would be very upset with me after what we have been through. But I don't think they are adequate. I think we need to do what Judy England-Joseph talked about, and that is we need to get a comprehensive assessment of these projects.

And if we have to—

Mr. ZELIFF. Immediately?

Ms. GAFFNEY. Immediately. And if we have to pay big bucks to do that, then I propose to you that we should do that.

Mr. ZELIFF. That is step one?

Ms. GAFFNEY. That is step one. Step two, concurrently—we should be working with the Congress right now. We should be drawing attention to the need for legislative change. I don't know how.

Mr. ZELIFF. And what is step three?

Ms. GAFFNEY. Step three is to continue with the systemic changes that are under way that aren't going to help us in the short term, I think.

Mr. ZELIFF. Judy, just quickly—

Ms. ENGLAND-JOSEPH. First step, leadership. One of the things I found when I went to visit some of the field offices after our hearing was that the message had not gotten out to that field office staff. Changes were not under way. It was business as usual.

Business as usual is the culture associated with doing nothing, limiting ourselves because of all of the excuses about lack of resources, lack of knowledge, when I think some of this can be fairly simple.

Two, I think we need to do inspections. We have got to go out and do the very thing we have on the books, saying we have to go out and inspect these properties, document those inspections. We reported last time they don't even document—it is poor documentation on the part of HUD, so that anyone has a track record to take action.

And three, take action against owners.

Mr. ZELIFF. Mr. Chairman, in fairness, at some point in the other questioning I hope we will have a chance to give the Secretary to respond.

Mrs. THURMAN. Mr. Chairman, I would yield my time so that we could continue this.

Mr. ZELIFF. I don't think it is fair to you if you can't respond.

Mr. RETSINAS. I don't take it in that spirit. There is enough blame to go around. I could, for example, point out that over the last decade, a number of inspectors were cut by the administration and the Congress by 25 percent, but that does us no good because that is the past and that is the result.

I would agree with Ms. Gaffney, as I heard her synopsis, that the focus is appropriate. We must be prepared to pay the price for what we need to do, invest in systems and other kinds of things we need to do.

Second, we need the legislative changes and the flexibility. I endorse that. I endorsed it a year ago. I endorse it today. I will endorse it tomorrow. This is something we need to do.

Third, we need to focus on systematic change. We need to take time and focus on time. We need to have a new way of doing business.

Judy's point is also well taken. We are in the middle of a reorganization. A good part of that is changing some of the leadership structure, but we are constrained by very legitimate budget constraints. I don't question the constraints. We are constrained to pick that leadership structure from our current work force.

I wish we had the ability to call in some new people to help us. But we are not going to be able to do that. I think that is an appropriate focus.

Mr. ZELIFF. Thank you, Mr. Chairman.

Mr. PETERSON. Mr. Rush.

Mr. RUSH. Thank you, Mr. Chairman.

Mr. Chairman, I am very concerned about this particular problem we are dealing with and that we are focusing in on. I want to commend you for this hearing, the second hearing you have had regarding this particular issue.

I am particularly concerned because one of the projects that has been under the spotlight is in my district. I do know in the city of Chicago there are serious, serious problems in terms of Section 8 and Section 8 properties and how they are managed. And I am glad to have an opportunity to discuss this with the witnesses here, with the panel here.

Let me just ask, I guess the Secretary, there is some type of discontinuity between your assessment that is in your report here, that the tenants at the 6000 South Indiana Building, that they in fact did not have any complaints, that they did not voice any complaints.

This was given to me here. It says, "Resident complaints are virtually nonexistent." And I think that is at variance with your study, that the residents did complain, Ms. Gaffney, is that right? Ms. England-Joseph said that.

Mr. RETSINAS. We can clarify that, if you like. Congressman Rush, Helen's staff has personally visited this project, I would like her to respond to that.

Ms. DUNLAP. There are two reasons. One, unfortunately systemic, and part of the reality of what we have to deal with, which is that tenants over the years have given up on complaining to HUD. That is a reality of what we need to do to change the corporate culture, as Judy mentioned a few minutes ago.

The second is, as you know, we have had a rehabilitation effort going on at 6000 South Indiana, and since that effort has begun, and tenant complaints coming into the Department have dropped, as one would expect. I am certain if I went out to that property and interviewed the tenants, we would find a mix of views, as we do in most properties.

Mr. RUSH. Well, it seems to me, I have heard the recommendations and I have heard some of the testimony this morning, and I think that is one of the missing elements, frankly.

Tenants are the first ones who know about deterioration in a property. And they do complain. And if in fact there is no systemic way of including those complaints into your process that would trigger the agencies to respond, and if the tenants aren't encouraged to complain—a lot of time tenants don't complain because they have a property manager who is intimidating, they have got other kinds of environments that exist there, they get frustrated in the process, and I think that that has really given tremendous cause for the type of deterioration across the board.

And I just don't see or hear anything, Mr. Chairman, relative to how we are going to include, empower tenants to be involved in terms of the problem-solving procedures in these sectional developments.

Ms. DUNLAP. Congressman, let me respond specifically: as we conduct property inspections with the SWAT teams and by the field offices, we have a new policy which invites tenants to participate in those inspections.

That is a new behavior. I must tell you also that that is a difficult behavior for HUD employees who for many years have seen, as have both the managers and the owners, the residents as a commodity in the marketplace. Involving those residents not just in the inspections but in the overall planning for that property, is very much part of our strategy. I could spend quite a bit of time outlining specifically some of the other things we are doing.

Mr. RUSH. Mr. Chairman, if I could just say this, you know, still you are only going to involve tenants through the SWAT team, which is going to limit the tenants' capacity and enthusiasm—

Ms. DUNLAP. That is not what I said. We are inviting tenants whenever we inspect properties to know about that inspection and to be available if they are interested in participating.

Mr. RUSH. What kind of methods are you going to employ prior to your inspections? If a tenant began right now, if a tenant has a serious problem in terms of plumbing in an apartment and they can't get any kind of response from the management because of indifference by the management, then what is that tenant to do?

To wait for to you inspect that property, and when you have got 6,000 pieces of property across the country you have to inspect, they have got to wait until you get around to them in order to get some redress from the system?

Ms. DUNLAP. I understand the question. At this point we don't have enough people to go out on every single tenant complaint. I can tell you that we are changing our response to those complaints by talking to those tenants.

If we are going to do what you suggest, we are really going to need a system of intermediaries to work with us to respond to those complaints as they come in. And frankly, more importantly, change the relationship between managers and tenants.

Let me give you an illustration of something we did last week that I think represents that. We brought together 20 of the largest management companies in this country and major tenant leadership, and spent a whole day work together on the new management handbook in the same room at the same time. There was a lot of new insight on both sides of the table. Those are the kinds of things we have got to do if we are going to change the tenant complaint process.

Mr. RUSH. Thank you, Mr. Chairman.

Ms. GAFFNEY. I would just like to say I have no doubt the Office of Housing is very concerned about the residents and it has been a long time coming in HUD, because I don't think the residents had been seen as our clients for years and years.

But I would say to you, it would be a mistake for HUD, as much as we care about residents, to try to be responsive to them. The people who are benefiting from this whole system and this whole program financially are the owners.

Now, what is wrong with the system that the owners don't have to care what the residents have to say? That is the question. And that goes to the program design, truly it does.

Mr. PETERSON. It is disconnected, the way it is set up. It doesn't have anything to do with residents because somebody else is paying the bill. That is the problem.

Mrs. THURMAN. I have lots of questions, but I understand time is at a premium.

Mr. ZELIFF. She is a great American.

Mr. PETERSON. That will be in a brochure next week.

Ms. Joseph, you have been out visiting, and what I have heard is that when you go out to these field offices, they are telling you it is pretty much business as usual. The message has not gotten out to these field offices. Is that correct?

Ms. ENGLAND-JOSEPH. Yes, sir. I have shared that with HUD officials, and it could be that in the last few weeks a message has gone out.

Mr. PETERSON. How do you respond to that?

Ms. DUNLAP. Judy shared that. First I have had several conversations with field offices as a result.

Second, we put a lot of people from headquarters in the field during the month of September. Their primary message was that enforcement is the No. 1 activity of the department and habitability of property is our goal.

And lastly and most importantly, we are modeling that behavior through a series of foreclosures, many of which are represented by the people sitting behind me.

Mr. PETERSON. We need to get HUD focused. I think we have got their attention. How much of this problem is caused by us?

If we don't pass these bills and give them the flexibility to get rid of some of these dumb ideas we have put in the statute, how much chance do they have of fixing this?

Ms. ENGLAND-JOSEPH. One of the things you asked us to do is look at the Edgewood Apartments here in DC. I would presume that one question that would be a bottom-line question is, after all that analysis, what shall we do with that property?

Under current law, HUD would have to spend around \$37 million in order to rehabilitate it, in order to then finance it through rents that would be able to cash-flow that property for the useful life of that property.

The choices to HUD in trying to decide whether they should demolish it because it may not be worth that investment, it may just be the kind of property that we should say, folks, no more money, don't pour good money after bad, let's walk away, let's do something else with that money.

HUD can't do that. So the simple question for today is, they can't make the kind of choices that I think you are asking them to make, and those are legally bound.

Mr. PETERSON. How are we going to get these other committees that have the ability to change this to do it?

Ms. GAFFNEY. I think one of the problems is that we see this as a crisis, but no one else seems to; there is a feeling that we can continue doing business as usual.

Mr. PETERSON. Why is that?

Ms. GAFFNEY. Perhaps we haven't presented the situation—Chris, do you have views?

Mr. PETERSON. Has this been given to these committees when they were in the decisionmaking process on this, and they just say it is too much to deal with, so—

Ms. GAFFNEY. Can I just say one thing—

Mr. PETERSON. They picked up a few things but they didn't pick up enough. Even if we pass the bill that is over in the Senate, it still doesn't give you everything you need.

Mr. RETSINAS. It is better. Better would be good.

Mr. PETERSON. But it does not give you what you need.

Ms. GAFFNEY. I think what needs to happen is there needs to be a real dialog between OMB and HUD and the Congress, a serious dialog, which to my knowledge hasn't happened, on all aspects of this multifamily program. And I just think that people are afraid perhaps to even—

Mr. PETERSON. Face it.

Ms. GAFFNEY [continuing]. Face it. I want to give you an example. I think it was in April, we issued an audit report on the prepayment and preservation program. And as a reinvented OIG, we had taken it on as a major policy issue, and we sent that report to every congressional committee that we could think of, told them we thought it represented a scandal, said we would do anything to work with them.

We got no response.

Mr. PETERSON. After the election, maybe we should call a summit, and get all of these people in one room. I will help you do that. We have got to sit down, outside of the regular process, and try to get everybody in the room, and just take this thing on, because it is going to get totally out of control, if it isn't already.

Mr. RETSINAS. I would welcome that. We would want to be a part of that, of course.

Not in defense of your colleagues, but I think what often happens is there are well-intentioned goals and objectives, and each individual objective for each individual program may sound OK, but when you stop to aggregate it, it doesn't make sense. That is why we ask for flexibility. I can't answer the question of why it wasn't granted, in part because of mistrust from the past, in part because of conflicting public policy objectives. But Susan is right, you are right. The time is upon us. It has been upon us. And we certainly appreciate getting your attention on this important matter.

Mr. RUSH. Mr. Chairman, if you will yield for one moment, as a member of the Banking Committee which has jurisdiction on this, I know there is an extreme amount of work we have been involved in, and a lot of results we have been able to achieve over the last—this last term here. And I do agree, though, that as part of our deliberations, I am a Member of the Subcommittee on Housing in the Banking Committee, you know, we focus on public housing, then we are missing Section 8 type housing. We focus on mortgages and credit lending and credit-style communities and how mortgages—the CRA requirements, then we are missing a certain aspect.

So I think there needs to be some overall coordination particularly in the area of Section 8 housing and public housing. And we can get an overall game plan rather than focusing in on one aspect of it per term.

Mr. PETERSON. Yes, I think that has been part of the problem. We try to fix something, and it pops up somewhere else. One hand doesn't know what the other is doing. That is why we need to call a summit and get everybody together.

Mrs. Thurman, we have got a couple of minutes.

Mrs. THURMAN. Mr. Chairman, the only thing I would say, because I think we are headed in a positive direction here, and I don't know how it works up here, but it may be to our advantage to even send a letter from this committee to put them on notice so that they recognize we are very serious about this, and also letting the committees that would handle this kind of legislation also be on notice, to kind of follow up with what Susan has said.

I mean, they couldn't even get a response. That is pretty significant to me, that if there is an emergency out there to a situation that is not happening, we need to, as those that are supposed to be looking at the operations, make those committees and those

folks aware there really are some problems so that we can correct it.

Mr. PETERSON. We sent letters on public housing, and they did respond and put it in their legislation. So we did make some progress. But in the Senate, somebody woke up with a hangover and it came out again.

Hopefully, we can do something similar. I think the problem is that when they have been asked what can we do the traditional response is, "more money, more people." They don't want to hear that. That is not going to work. There is not going to be more money and more people. We have to give them the flexibility to bite the bullet on these projects and do what has to be done. It has got to be something that politically some people aren't going to like because it is going to impact tenants and owners. But we have got to do it. We can't just keep papering over this and putting it back in the corner.

Mrs. THURMAN. Mr. Chairman, and the reason I even bring that up is because staff will be here during these next couple of months, and maybe as they are——

Mr. PETERSON. Well, we will be here. We will be here to deal with GATT. Maybe we can convene something in December. Because I don't think we can wait until we get into the appropriation and authorization process. It is too late. You have got this whole train going by that time. So let's try to do something in December.

I thank you all very much for a very constructive dialog and testimony.

Mr. PETERSON. We will move to the next panel. We have Austin Fitts, President, Hamilton Securities Group, and Former Assistant Secretary for Housing, Federal Housing Commissioner. We have Austin Fitts, President, Hamilton Securities Group, who had the job before Mr. Retsinas at HUD.

We have Phillip Comeau, vice president of Multifamily Asset Management, Federal Home Loan Mortgage Corporation.

And Deborah Austin, Director of Legislation and Policy, National Low-Income Housing Coalition.

Thank you for being here. It is the custom of our committee, as you know, to swear in all witnesses. I assume you don't have an objection. Please stand and raise your right hand.

[Witnesses sworn.]

Mr. PETERSON. Your statements will be entered in the record in their entirety. I ask you to summarize as best you can, and recognize the time constraints. We have about 37 minutes, and they are going to cut us off.

So, Ms. Fitts, I appreciate you being with us today.

STATEMENT OF C. AUSTIN FITTS, PRESIDENT, HAMILTON SECURITIES GROUP, AND FORMER ASSISTANT SECRETARY FOR HOUSING, FEDERAL HOUSING COMMISSIONER, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. FITTS. Thank you very much. I would like to thank the committee for this opportunity to speak to you. I have submitted written testimony for the record, and rather than make an opening statement, because of the press of time, in fact what I would like to do is respond to one question or really two questions that I

thought were excellent, and I think it was the gentleman to your right who said, one, two, three. What I would like to do in summing my testimony is give you my one, two, three.

Here are some of the things I think you need if you really want to fix this portfolio on a timely basis. One of the things that would help the department do this is a substantial investment in a PC-based network throughout HUD that is not dependent on the HUD mainframes. While this may sound like a very minor detail in terms of operational capacity to collect information, to know what is a troubled project on any kind of a timely basis, this is extremely important.

Second of all, continued support from this committee for the department to continue to issue insurance on a reinsurance basis as opposed to through one mortgage at a time. What this permits HUD to do is to, as the Inspector General stated, reengineer the programs so that when servicing is needed over time, it is done by a local partner who is far more competent to do that or national partner who is far more competent to do that than a Federal bureaucracy can possibly be.

Third of all, I would continue to support the idea of disposition strategies in subcontracting where they make sense, including subcontracting master servicing on mortgage insurance in force which would permit far more—I think you stated, Mr. Chairman, looking at 100 properties is not doing something on a scale where you have 20,000. That would give the department I think a very prudent way to do it on a huge scale quickly.

To address the issue of doing what has to be done, to be perfectly blunt, when Congress decided they wanted the S&L real estate portfolio cleaned up, they gave tremendous expedited operational freedom to the RTC, whether it was waiving constraints under FAR, whether it was the ability beyond civil service rules to bring in very qualified people on one 1 and 2-year positions.

In this instance what could be done is to provide for these resources to be funded out of the FHA fund, which is an existing provision, but it would require working with the budget committees and OMB, but it would frankly be very minor, and the scheme of the money saved could easily be done. We are talking about tiny dollars in the scheme of the savings to the Federal Government.

The last thing I would do is hold hearings or make sure the Banking Committee held hearings on what it would take to make tenant-based subsidies work. There is no doubt, Mr. Rush, that tenants know what to do. But they can't do it with tenant-based subsidy if that tenant-based subsidy is not responsive to the information they have.

It is not enough to say you are empowering tenants. You have to empower tenants, if that is what you are going to do it also needs to move from project-based subsidy to tenant based.

The last thing I would do is face the economics of both project-based Section 8 and its relationship to the FHA fund. Frankly, I don't think that we are going to lose a lot of money if we face this situation. I think the Federal Government, because much of this stock is insured by the FHA fund, is paying 2 or 3 times for a property when it is a lot cheaper to just pay once. And by moving Section 8 subsidy over time to economic rents and restructuring the

debt that the Federal Government is liable for, what will happen is you may spend some more money today, but you will save \$2 to \$3 in the FHA fund over time.

So I would submit to you that the conventional wisdom that it is expensive to fix this problem may be misleading. It is probably more expensive not to fix this problem. That is just on the Federal income statement. It doesn't include the cost to the neighborhoods and tenants and many other people. And I will say this, the value of private property owners next door will drop as a result of not fixing this problem.

So if I had to give you a list of one, two, three, I made it a little bit longer, but those are the items. I would recommend that a joint action by the Banking Committees and some of the Budget Committees, with OMB in the room, could fix this if the goal is to fix the portfolio.

[The prepared statement of Ms. Fitts follows:]

Testimony of C. Austin Fitts

**U.S. House of Representatives
Committee on Government Operations
Subcommittee on Employment, Housing and Aviation**

October 6, 1994

**The Hamilton Securities Group, Inc.
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Testimony of C. Austin Fitts

Good Morning Mr. Chairman and Members of the Subcommittee.

Thank you for providing me the opportunity to testify today on Section 8 project-based assistance. My name is C. Austin Fitts, and I am a principal at the Hamilton Securities Group, a real estate merchant banking firm located here in Washington, DC.

My knowledge of this area is based primarily on my experience serving as the Assistant Secretary for Housing/Federal Housing Commissioner at the U.S. Department of Housing and Urban Development from 1989-1990. For a more complete description of my background, I have attached my resume to this testimony. As described there, my career has focused on the U.S. financial system and a broad range of capital markets. We have focused at Hamilton on housing, real estate and economic development, primarily in underserved markets. Attached as an Exhibit is a recent study we undertook of the multifamily mortgage markets.

Mr. Chairman, let me first disclose that Hamilton Securities serves as HUD's financial advisor and loan sale advisor on the asset management and disposition of its multifamily mortgage portfolio. I want to reiterate for the Committee, Mr. Chairman, that I am not here in that capacity, but as a member of the private sector. The thoughts here are my own, and do not reflect any relationship or special knowledge of the Department's activities in the project-based Section 8 area.

Let me commend you and your Subcommittee for holding these hearings and for addressing such an important issue. The multifamily portfolio assisted and financed by HUD represents the largest multifamily position of any owner or financial institution in the United States. The portfolio -- its condition, ownership, location and economics -- is complicated, and its management has long-term liability and budget implications for the federal government. Most importantly, its current legal and regulatory constraints are not in sync with market realities and prudent management going forward. Someone must tackle this issue before it consumes the Department, and I want to commend you and your Subcommittee for undertaking this challenging task.

I. Section 8 Project-Based Subsidy: A Strategic Framework

HUD is the largest single investor in apartment buildings in the country -- larger than any private real estate company, larger than Freddie Mac and Fannie Mae, larger than any state or local government, and larger than any other federal agency with property assets.

All US real estate -- single family, multifamily and commercial -- underwent profound changes beginning in the mid-1980s, from which the country is still adjusting. Essentially, an industry that had for years been driven by profits from capital gains -- fueled by tax benefits, inflation and inflows of capital and federal credit -- experienced a sudden and substantial market correction. And the trigger for this correction was profound change in our nation's economy

For a variety of reasons as we move from an industrial to an information economy, increased productivity is best served by reducing subsidies provided to real estate. And indeed, several factors did in fact converge in the late 1980s to diminish incentives for investment in real estate, including apartments. These factors included reduced inflation, as well as federal tax, credit and regulatory changes. The result was a substantial "mark to market" of the value of virtually all income producing properties.

Following the passage of the 1986 Tax Act and the Financial Institutions Reform, Recovery, and Enforcement Act in 1989, the value of the nation's multifamily portfolio decreased significantly. It has taken the real estate and the capital markets some time to recognize and grapple with the size and nature of this reduction in value.

The savings and loan industry was the first part of the real estate world to have to deal with declining portfolio values. In passing FIRREA, Congress essentially dictated that the S&L industry mark its portfolios of mortgages and real estate to market -- and face up to its losses through disposition. Assets were to be sold at whatever price the market would bear. In the process, the Resolution Trust Corporation led the way in the restructuring and recapitalization of a meaningful portion of the nation's real estate. The RTC did a commendable job of inventing a new market for investing and valuing real estate in this new and more productive world.

The RTC's efforts, coupled with pressure from federal and state regulators, led other private financial institutions -- banks, insurance companies and credit companies among them -- to begin to mark down the value of their own portfolios and dispose of these assets. This process has continued to fuel the development

of a liquid market for disposed real estate and mortgages, a secondary market for resulting securitizations, and an infrastructure of increasingly productive and efficient servicing and asset management organizations.

So here we are in 1994. The federal government has taken the lead in stimulating the nation's transition to the required lower levels of investment in real estate. The federal government has forced private financial institutions to recognize the reality of their own balance sheets and take actions to put their finances and operations on a healthy and realistic basis. Make no mistake about it. The federal government showed great leadership and courage in facing this issue in the late 1980s. Our economy and our real estate markets are much healthier today for it, even though transition has been difficult.

You are probably wondering how all of this is relevant to our discussion of Section 8 project-based subsidy? The reason is that to discuss an issue, you must first understand what the problem is. And the major problem facing Section 8 project-based subsidy is not that this is a structurally flawed program -- although it certainly is. Section 8's flaws are a symptom of a far wider problem -- one faced not only by HUD in its portfolios of real estate, mortgage assets and loans -- but also by credit and loan programs throughout the federal government.

The problem is that despite all of its outstanding efforts to convert the private markets to sound balance sheet practices, the federal government has failed to apply the same requirements and sound financial management practices to its own balance sheet. And nowhere is this problem more evident than in the federal portfolios related to real estate.

Why has the federal government failed to face economic reality and restructure its own real estate assets? There are three reasons. First, the government did not wish to have to bear the implications to its current budget of recognizing this financial reality. Better to pretend that the market would go up -- and defer the problem a little longer. Secondly, the operational implications of what is required to fix the problem are significant, and would require substantial programmatic and administrative changes. Third, recent reforms, supported by this Subcommittee, are finally providing reliable financial reporting to Congress through audited financial statements and actuarial analysis. Public officials are now becoming equipped with the information necessary to understand, quantify and address the costs of not applying the same standards to their own portfolios.

Despite the difficulties, however, the federal government must now mark its own portfolios to market -- just as it required the private financial institutions it regulates to do as a matter of sound management practice. The time has come to free these assets from the burden of trying to hold to a value they cannot produce and to permit a healthy and sensible recapitalization of the Section 8 portfolios. This must be accomplished in a manner which delivers taxpayers an appropriate social and financial return on their investment and fulfills the fundamental purposes for which these important assets were created.

To relate this strategic framework to the specifics of project-based Section 8, we need to look at both the Section 8 program -- as well as Section 8 within the context of overall federal housing policy. I would recommend that the Committee's work would be made easier by establishing a series of guidelines to determine the best way to move forward in addressing Section 8's programmatic flaws. I have suggested some guidelines below.

II. Section 8 Project Based Subsidy: Guiding Principles for Addressing Programmatic Change

There are 164 basic fact patterns in the assisted housing portfolio. To fix project-based Section 8 in a way that improves the situation, rather than causes tremendous lost, waste and dislocation, the federal government must design an action plan based on workout tools that are responsive to the great diversity of local markets and real estate throughout the nation. Imposing a single national model is one of the greatest dangers before us.

The Section 8 project-based portfolio is, for all intents and purposes, the FHA mortgage insurance portfolio. A substantial majority of FHA's General Fund mortgage insurance outstanding is collateralized by properties which are supported by federal project-based subsidy. If Section 8 properties are written down to reflect the reality of economic rents -- either today or as contracts mature for renewal -- we will by definition address the substantial mark down and restructuring of the related federal government debt.

The recapitalization and restructuring of the Section 8 portfolio can only be done on a prudent and fiscally sound basis if appropriate resources are provided. Asking the current HUD operation to design and execute a successful restructuring under current regulatory and operational restraints is akin to landing U.S. forces on the beaches of Normandy armed with water pistols. When Congress determined that the S&L portfolio had to be restructured, the lawmakers provided the requisite resources and administrative flexibility. The RTC was given exemptions to Federal Acquisition Regulations, Civil Services provisions and other regulatory provisions. If this Subcommittee is serious about restructuring the Section 8 portfolio in a manner that is consistent with prudent

use of taxpayers' dollars and responsive to the needs of neighborhoods and communities, it must address the issue of the moratorium on Congressionally-imposed operational constraints. It must also support HUD's recommendations at the end of this year to restructure FHA's operations on a permanent and enduring basis so that if we fix this problem, it will not be repeated.

For a program restructuring to work, Congress must create incentives for capable property managers and owners to assume responsibility for the success of the portfolio in partnership with HUD and for undercapitalized and inefficient owners and managers to leave the portfolio. The criteria of any plan must focus on the needs of tenants and neighborhoods and the value of the taxpayer dollar -- not on ideological wars between the private and public sector.

Properties -- like cars and toasters -- at some point need a place to go to die. Congress must support a policy that permits removing properties from the stock without a unit-for-unit replacement requirement. Otherwise, we will continue to spend substantial amounts of money to house one family in one unit which could pay for up to five families to be housed in five units. If a piece of real estate doesn't work anymore, there is no policy in the world -- and no amount of money -- that can save it.

Recapitalization of the Section 8 portfolio should be subject to performance standards which HUD can track and use to demonstrate how the federal government is maximizing the number of people served and housing units made available for the dollars expended. Without clear and measurable standards, this portfolio and program will go astray again. This Congress needs to assume responsibility to encourage HUD to invest in the

information infrastructure necessary to make prudent management possible. There is no higher return on the taxpayers' dollar than that which the Department could derive from a consistent and reliable flow of information on a time basis about its financial and real estate assets -- chief among them the assisted housing portfolio. The committee needs to take active steps to make sure HUD is given the resources and authority to make this investment.

A successful Section 8 recapitalization requires that Congress support HUD's "A" Team. This Subcommittee should work with and support HUD's leadership. The Administration's housing team represents experienced and seasoned housing professionals, the best and the brightest of a new generation of experts in housing and community finance. They have earned their stripes in state and local government and the private sector. I believe it is the housing industry's perception -- and fairly so -- that if this Congress will not support management changes led by the "A" Team, FHA and HUD will pass the point of no return in their ability to serve the assisted housing portfolio, as well as the fundamental federal housing mission. Congress should view the presence of this team as an opportunity to finally implement important and lasting improvements.

III. Section 8 Project Based Subsidy: Guiding Principles for Strategic Change in the Context of Overall Federal Housing Policy

Two important issues under the jurisdiction of other Committees need to be considered in the context of restructuring Section 8. The first issue is **budget outlays**; the second is **exit taxes**. The continued attempt to lower budget outlays for Section 8 is triggering outlays through the FHA fund in later years -- in substantial excess of what was saved on Section 8 spending in the

first place. Failure to recognize the financial relationship between Section 8 and FHA insurance in the appropriations process is causing the federal government to borrow money from itself at interest rates that would make a loan shark blush. As for exit taxes, many of HUD's private sector partners are limited in their ability to rehab, workout or transfer Section 8 properties because of recapture liabilities. While it is absolutely legitimate to argue that these owners received the benefit of this depreciation and should be liable under recapture, the reality is that so long as a restructuring causes recapture problems that owners cannot or will not handle, the properties fester and the tenants suffer. We must decide which is more important: building neighborhoods or punishing developers.

It is time to make vouchers and tenant-based subsidy work. One of the fatal flaws of project-based subsidy is that it has reached a level of complexity that would stump Albert Einstein. The desire for a simple solution is understandable and wholesale replacement of project-based subsidy with vouchers over night sounds convenient. However, this is a dog that will not hunt. Over time, vouchers can be made a far more cost efficient approach -- but only if there is serious programmatic reform of vouchers. Making vouchers work is not a matter of more money. Rather, it requires reaching into the heart of darkness of racism as it is practiced in local housing markets throughout the country -- and doing something about it. If we are not prepared to make tenant-based subsidy work, we will be hard pressed to evolve out of project-based subsidy.

We must beware of the three greatest fallacies about housing policy to have an informed debate about Section 8. First, contrary to conventional wisdom, it is more expensive to the federal government to not restructure this portfolio than to restructure it.

Second, only a minor portion of the overall federal housing budget goes to low and moderate income people. While it may be newsworthy to focus on the waste that occurs on subsidies for low and moderate income people, the waste that occurs from broader tax and credit subsidies which benefit the rest of society is just as real.

Third, investment in neighborhoods in underserved markets -- both urban and rural -- is not only important to the nation's economy -- it can be done effectively and responsibly. But we have to be willing to contemplate substantial change.

Finally, we must remember. Restructuring the Section 8 portfolio is not primarily about fixing real estate. The federal government lost money on this portfolio because it spent lavishly on bricks and mortar -- but failed to make the properties serve the tenants or the surrounding neighborhoods. This time around, the restructuring plan must provide for the necessary investment in people and communities -- in partnership with a diverse group of community builders -- public, private and nonprofit. This is not only a matter of public policy. It is necessary to ensure that the portfolio is placed on a sound economic basis and that the restructuring itself represents a prudent investment going forward.

In closing, let me thank you again, Mr. Chairman, for the opportunity to join you and the Subcommittee. I hope these comments are of assistance to you and the other members as you address Section 8 project-based subsidy issues. Thank you for your commitment to housing and for your dedication to sound and responsible government. I look forward to responding to any questions that you and the Subcommittee may have.

Mr. PETERSON. Thank you. That was very good.
Mr. Comeau.

STATEMENT OF PHILLIP COMEAU, VICE PRESIDENT, MULTIFAMILY ASSET MANAGEMENT, FEDERAL HOME LOAN MORTGAGE CORPORATION

Mr. COMEAU. Mr. Chairman and members of the subcommittee, my name is Phil Comeau. I am vice president of Multifamily Asset Management at Freddie Mac. Thank you for inviting me here today.

Let me start by saying that while I am not an expert on HUD-financed projects, Freddie Mac has had significant experience in managing distressed real estate and I hope my insights will be helpful with regard to HUD's loan portfolio.

Before I begin, I would like to take a minute to commend Assistant Secretary for Housing, Nic Retsinas, and Deputy Assistant Secretary Helen Dunlap, on their tremendous efforts to bring HUD's multifamily portfolio under control. These two people have the expertise, compassion, and commitment that are necessary to tackle the significant problems that face HUD with respect to multifamily housing.

Moreover, I commend the subcommittee for its efforts to address HUD's need for resources and flexibility to effectively deal with its multifamily portfolio.

In late 1990, Freddie Mac had an \$11 billion multifamily portfolio of 12,000 loans which began to hemorrhage badly. The combination of poor initial underwriting, a soft economy in certain regions and overbuilding, resulted in rents being depressed while operating expenses increased.

As a result of these factors, many properties were not able to pay both their operating expenses and the mortgage payments. Delinquencies shot up to a peak of \$760 million, and our real estate owned properties, or REO, those that we own through foreclosure, hit a peak of 250 properties.

Out of necessity we have become very proficient in performing loan servicing and managing both delinquent loans and REO. Our troubled portfolio was about one sixth the size of HUD's.

I would like to stress, Mr. Chairman, that stabilizing our portfolio, reengineering our systems, and restructuring our multifamily division was a long and arduous task.

Furthermore, it did not happen overnight. Our lessons came at considerable cost.

We suspended our multifamily program for 3 years beginning in 1990 when we realized the gravity of our multifamily problems. At that time, multifamily represented only 3 percent of our portfolio but generated almost half of our losses. Since that time we have written off over \$600 million.

Our success in turning around our multifamily portfolio was the result of, No. 1, developing a state-of-the-art management information system; No. 2, hiring experienced asset management professionals; No. 3, developing expeditious processes that give our staff the authority to make and implement timely real estate judgments; and No. 4, substantially upgrading the quality of our seller/servicers.

We are now back in the market of making new loans and expect to originate about \$1.4 billion of new business this year.

Freddie Mac's asset management process is fairly simple. On performing loans, a qualified seller/servicer does a physical inspection, determines income and expenses, and values the property annually.

I would like to repeat that. This is all done annually. This information is transmitted to us electronically and on any given day we can generate reports and analyses which analyze the portfolio in a wide variety of ways.

If a loan becomes delinquent, we move very quickly and decisively to inspect the property, value it, and develop a resolution plan. One of the lessons we have learned is that time delays result in asset deterioration from both deferred maintenance and tenant frustration.

If a property is being managed well, our preferred resolution strategy is to do a workout. In our workouts, we will accrue that portion of debt service which the property cannot support. We will advance new money to stabilize the property if this investment results in a comparable increase in value.

Our workouts on overleveraged properties are done recognizing that the most we can expect to accomplish is to stabilize the property and receive 100 percent of current market value which can be substantially less than the current loan amount.

If the loan goes into REO, we immediately bring in a property management company that is skilled in distressed real estate to address life and safety issues and to address asset preservation needs. Our objective is to protect the tenants by providing decent and safe housing in these properties.

We list our REO properties with local brokers and generally sell them one or two at a time. Our average REO hold period is approximately 11 months. We perform due diligence reviews on the buyers to assure that we are not selling to "slumlords." Our experience demonstrates there is a strong private market to buy REO. In addition, most of our REO properties are affordable to families with incomes of 50 to 70 percent of median.

We have found that seller financing and rehabilitation financing is critical to selling certain properties and ensuring that these properties will be operated in a decent manner. For example, a five to \$6,000 per unit investment in many projects will convert them from a blighted property to decent, affordable housing.

We have learned that distressed loans do not mean that the properties are slums. However, these properties will become slums and suffer serious asset deterioration unless the problems causing the delinquency are dealt with promptly. An early warning system is critical to uncovering the problems at a point when prompt action can be taken.

Now, I would like to focus my comments on issues that Congress and HUD should consider in addressing HUD's troubled portfolio. My observations and recommendations come in part from Freddie Mac's experience in cleaning up its own portfolio and redesigning our program. Freddie Mac's success was due in large part to the flexibility we had as a private corporation. We are able to act quickly to implement solutions and deploy the necessary resources.

As a government agency, HUD is in an entirely different situation. However, some of the lessons we have learned at Freddie Mac can and should be considered by Congress and HUD.

There is no doubt that HUD has a huge problem portfolio that will be expensive to fix in the best of circumstances. However, HUD can reduce its ultimate losses by billions of dollars if it utilizes strong asset management techniques. Although the problem is enormous, I believe that it is imminently solvable.

My conclusions and recommendation with regard to HUD are as follows. First, clear and consistent objectives are critical to success. HUD and Congress needs to agree on the desired objectives. Do you want to minimize losses, or do you want to retain housing stock at any cost, or do you want to strike a balance between these two?

In addition to clarifying the objectives, I believe that the following actions are important first steps.

First, develop and implement a state-of-the-art management information system which will give HUD current and easy to use information.

Second, hire experienced professionals to make decisions and be accountable for them. Empower these professionals to make timely decisions—a quick 95 percent solution is far better than a slow 99 percent solution.

Third, streamline and simplify the decisionmaking process—an inefficient process can require twice as much staff as necessary.

Fourth, utilize the private sector via loan sales or asset management contracts. Vendors should be hired based on performance and results—not based on the lowest bid. Time is critical and HUD needs the ability to enter into contracts quickly and flexibly. Oftentimes, nonprofit organizations, although very well intentioned, do not have sufficient expertise or capacity to deal with distressed loans and REO in any quantity.

Fifth, broaden HUD's loss mitigation techniques. Workouts should be pursued with good borrowers. If foreclosure is pursued, HUD should recognize that generally the most they can recover is 100 percent of the property's current value, less foreclosure costs and less lost interest during the process.

Workouts need to be done with this in mind. The current loan balance is interesting but irrelevant at this point. In fact, HUD could benefit enormously from having the flexibility to make soft second mortgages for that portion of the loan balance that exceeds the current property value.

HUD also needs the flexibility to invest new money in many of these properties. Often a \$1,000 to \$2,000 unit investment in a property will generate far better results for HUD than foreclosure.

HUD should provide seller financing on its REO. Many properties have substantial deferred maintenance and also will need rehabilitation financing which HUD should be authorized to provide.

Sixth, when HUD wants to cancel a project-based Section 8 contract for poor performance, HUD should have the discretion to transfer the project-based Section 8 to tenant-based Section 8 assistance. Without this authority HUD can't penalize poor property managers without also penalizing the tenants.

Seventh, to the extent that Congress and HUD continue affordability restrictions on projects sold out of REO, they should recog-

nize that private financing is only feasible for such projects to the extent that 15-year project-based Section 8 is available to cover the restricted units.

Eighth, HUD needs to alter borrower behavior by enforcing remedies and replacing poor property managers.

In conclusion, Mr. Chairman, I would like to say that while much work needs to be done, recent actions taken by Congress as well as many of the initiatives embarked upon by HUD are steps in the right direction and clearly demonstrate their understanding and commitment to resolving their problems. There is no doubt, however, that these efforts are often hampered by regulatory and statutory barriers.

Without changing these regulatory and statutory barriers and providing the necessary resources, HUD doesn't have a fighting chance to fix the problem.

I again commend you and your subcommittee for your efforts to determine the appropriate tools and strategies to allow HUD to move forward.

I will be happy to answer any questions you may have.

[The prepared statement of Mr. Comeau follows:]

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TESTIMONY OF PHILLIP E. COMEAU

Freddie
Mac

VICE PRESIDENT OF MULTIFAMILY ASSET MANAGEMENT

FEDERAL HOME LOAN MORTGAGE CORPORATION

BEFORE THE SUBCOMMITTEE ON EMPLOYMENT, HOUSING
AND AVIATION

COMMITTEE ON GOVERNMENT OPERATIONS

OCTOBER 6, 1994

Mr. Chairman and members of the subcommittee, my name is Phillip E. Comeau, I am the Vice President of Multifamily Asset Management at the Federal Home Loan Mortgage Corporation ("Freddie Mac"). Thank you for inviting me here today to discuss Freddie Mac's multifamily housing program, and specifically our asset management process for our multifamily properties. I appreciate this opportunity, and while I am not an expert on HUD-financed properties, Freddie Mac has had significant experience in managing distressed multifamily loans and I hope that our insights will be helpful.

My testimony includes an overview of Freddie Mac and the secondary mortgage market, a brief history of Freddie Mac's past multifamily problems and the lessons we've learned, and finally, a description of our asset management processes and some observations and recommendations regarding HUD's troubled loan portfolio.

Before I begin, I would like to take a minute to commend the Assistant Secretary for Housing, Nic Retsinas, and the Deputy Assistant Secretary for Multifamily Housing, Helen Dunlap, on their tremendous efforts to bring HUD's multifamily portfolio under control. These two people have the expertise, compassion and commitment needed to tackle the significant problems that face HUD with respect to multifamily housing. Moreover, I commend this subcommittee for its efforts to address HUD's need for resources and flexibility to deal effectively with its multifamily portfolio.

I. OVERVIEW OF FREDDIE MAC AND THE SECONDARY MORTGAGE MARKET

America has the best housing finance system in the world, in large part due to the existence of a strong secondary market. Today mortgage credit is widely available across the country on the best terms that the capital market has to offer. We estimate that the efficiencies produced by the secondary market have saved American homebuyers approximately 1/2 of one percent, or about \$5 billion each year.

Freddie Mac has played an instrumental role in the success of America's housing finance system. As part of the secondary market, Freddie Mac serves as a link between the primary mortgage market, where mortgages are originated, and the national and international capital markets. By purchasing mortgages with funds obtained from the capital markets, Freddie Mac enables individual homebuyers to obtain mortgage credit at the lowest possible rates. Freddie Mac purchases conventional mortgages from primary lenders across the nation and packages the lion's share of those mortgages into securities. We, in turn, sell the securities to investors so

that the cycle can begin again. This allows a homebuyer in Minnesota the same access to mortgage funds as a homebuyer in California or New York.

Congress created Freddie Mac in 1970. Until then, the cost and availability of mortgage credit varied by region because the primary source of funds for mortgage credit -- thrift institution deposits -- was not always plentiful in the areas needing such credit. In addition, the individual homebuyer had no access to the national and international capital markets. Variances in mortgage funding affected not only the individual homebuyer, but also the housing market and economy as a whole.

Freddie Mac was created to address these issues by developing a national secondary market for both single and multifamily credit. To accomplish this, Freddie Mac and Fannie Mae built the infrastructure for this market through the development of standardized mortgage loan documents and underwriting guidelines that allowed the wholesale purchase of loans on a nationwide basis. Freddie Mac also assembled a network of primary market lenders, commonly referred to as Seller/Serviceers.

While Freddie Mac has been in existence for almost 25 years, the past five years have been a time of tremendous change for the corporation. In particular, the change from quasi-government ownership to wholly private ownership has been revolutionary.

The enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") significantly changed Freddie Mac's corporate governance structure. Prior to 1989, Freddie Mac's stockholders were savings and loan institutions and other members of the Federal Home Loan Bank System. Under FIRREA, our preferred stock was converted to common stock, and general public ownership of Freddie Mac was permitted for the first time. FIRREA also authorized a new Board of Directors for Freddie Mac, 13 of which are elected by the shareholders, and five appointed by the President of the United States. FIRREA completed the transformation of Freddie Mac from a quasi-governmental agency to a shareholder-owned private corporation. By providing stable corporate governance and access to equity capital, this change strengthened Freddie Mac's ability to meet the nation's housing finance needs.

II. MULTIFAMILY FINANCING

Since the mid-1980s, the combination of a soft economy and overbuilding of rental housing in certain regions has resulted in depressed rent levels. At the same time, operating expenses have increased. As a result of these two factors, many properties have not been able to pay both their operating

expenses and the mortgage payment and have consequently become distressed.

Freddie Mac suspended its multifamily purchase program in late fall of 1990, when serious delinquencies escalated, resulting in cumulative losses of more than \$600 million. At that time, multifamily loans represented only three percent of Freddie Mac's portfolio, but generated one half of our losses -- a loss rate 17 times greater than for single-family homes.

Some of the factors contributing to these losses, such as declining rents and property values, and increasing expenses, were not within our control. Other factors, however, were within our control. For example, many of our problems were the result of appraisals based on rosy projections of vacancy rates, unrealistic increases in rents and unrealistically low operating expenses. These appraisals were obtained by lenders and not adequately reviewed by Freddie Mac.

Another factor leading to Freddie Mac's problems was lenders who were not located in the same areas as the properties they serviced. For example, servicers located in Florida were managing loans in New York. Most did not know the local market or have the resources to inspect buildings. Many of these lenders walked away from their responsibilities when the loans became troubled and their costs rose. These factors were compounded by changing urban neighborhoods where crime and drugs were all too real a fact of life.

I can't overstate the deadly spiral that occurs when an owner either does not or cannot provide the resources needed to manage a property appropriately. In this scenario, apartment buildings will very rapidly lose quality tenants, vacancies will go up and rents will be forced down. If these problems are not resolved promptly, a property can become blighted within six to twenty-four months.

Freddie Mac learned two key lessons from its experience: First, sound multifamily financing requires well-designed programs, sufficient, experienced staffing and quality local lenders that know their neighborhoods and their business partners. Second, when a multifamily loan defaults, the tenants and the communities suffer, as well as the lender.

Freddie Mac was successful in turning around its multifamily portfolio because we worked to develop a state of the art management information system; we hired experienced asset management professionals; we developed expeditious processes that gave our staff the authority to make timely real estate judgments and implement them and we substantially upgraded the quality of our Seller/Servicers.

Under our new multifamily program, Freddie Mac will:

1. Purchase mortgages for the purpose of acquisition, rehabilitation and refinance of existing properties;
2. Use state-of-the-art tools to underwrite, monitor and manage our multifamily purchases; and
3. Select lenders for their capital and their multifamily experience in local markets.

Freddie Mac's redesigned multifamily programs will enable it to respond aggressively to the challenge of financing decent, affordable housing for America's renters. In 1994, we expect to commit \$1.4 billion in funds for multifamily housing.

III. FREDDIE MAC'S ASSET MANAGEMENT PROCESS

The following highlights key elements of Freddie Mac's asset management process:

- On performing loans, a qualified Seller/Service, each year, physically inspects the property, determines income and expenses, and values the property. Extensive loan information is transmitted to us electronically, and on any given day we can generate reports and analyses that examine the portfolio in a wide variety of ways.
- If a loan becomes delinquent, we move very quickly and decisively. One of the lessons we have learned is that time delays result in asset deterioration from both deferred maintenance and tenant frustration. When delinquencies occur, Freddie Mac personnel promptly inspect the property, value it and develop a business plan to resolve the loan delinquency. If the property is being managed poorly, we aggressively use receivers to stabilize it.
- If the property is being managed well, our preferred resolution strategy is to do a workout where the terms of the loan are changed in order to avoid a foreclosure.

In our workouts, we will accrue that portion of debt service which the property cannot support.

We will advance new money to stabilize a property if this investment results in a comparable increase in value.

Our workouts on over-leveraged properties are done recognizing that the most we can expect to accomplish is to stabilize the property and receive 100 percent of value. Recovery of any collateral deficiencies or accruals through property appreciation is icing on the cake. Any loan amount over current property value is in all likelihood not recoverable.

- We motivate the borrowers in two ways: one, by putting the borrowers money or legal rights at risk as a condition of the workout and two, by allowing the borrower to share in the appreciation of the property.
- If the property goes into REO, we immediately bring in a property management company that specializes in distressed real estate to address life and safety issues and to address asset preservation needs. Our objective is to provide decent, safe housing in these properties.
- We list our REO properties with local brokers and generally sell them one or two at a time. We undertake due diligence reviews on the buyers to assure that we are not selling to "slum lords". One reason that we do not do bulk sales is because we cannot do this same level of due diligence on the buyers.
- We have found that seller financing and rehabilitation financing is critical to selling certain properties and ensuring that the properties will be operated in a decent manner. For example, a \$5-6,000 per unit investment in many projects will convert them from blighted properties to decent affordable housing.

We have been selling properties at 100 percent of value and our average REO hold period is approximately 11 months. In addition, most of our REO properties are affordable to families with incomes of 50 -70 percent of the median. Our experience demonstrates that there is a strong private market for REO.

We have learned that distressed loans do not mean the properties are slums. These properties will become slums, however, and suffer serious asset deterioration unless the problems causing the delinquency are dealt with promptly. Problems that can lead to delinquency include poor property management, a sudden rise in operating expenses or a decline in revenues, or an unexpected capital improvement need. Each of these problems requires a different solution. Physical repair of the properties is essential to turning them around and stabilizing them. An early warning system is

critical to uncovering problems such as these so that prompt action can be taken.

IV. RECOMMENDATIONS

I would now like to focus my comments on issues that Congress and HUD should take under consideration as efforts continue with regard to HUD's multifamily portfolio. My observations and recommendations come in part from experience in cleaning-up our own multifamily portfolio and redesigning our program. It is important to recognize that Freddie Mac's success was due in large part to the flexibility we had, as a private corporation, in implementing appropriate solutions and our ability to direct and redeploy resources to these solutions promptly. As a government agency, HUD is in an entirely different situation. However, some of the lessons learned by Freddie Mac can and should be considered when developing strategies for HUD's own multifamily problems.

My conclusions and recommendation with regard to HUD are as follows:

- HUD and Congress should agree on objectives ~~do~~ you want to:
 - a) minimize losses;
 - b) retain subsidized housing stock at any cost; or
 - c) minimize losses while preserving decent, affordable housing.

However, regardless of the objectives, I believe the following actions are important first steps.

- Develop and implement electronically transmitted management information systems which will give HUD current information of loan status, value, income, expenses, property condition, market conditions, and other liens, if any. This information is critical and needs to be readily accessible for proper development of resolution plans.
- Hire experienced professionals who are willing to make decisions and be accountable for them.
- Empower these professional to make timely decisions ~~a~~ quick 95 percent solution is better than a slow 99 percent solution.
- Streamline and simplify the decision-making process ~~an~~ inefficient process can require twice as much staff as necessary.

- Utilize the private sector via loan sales or asset management contracts. Vendors should be hired based on performance and results ~~not~~ necessarily based on the lowest bid. Time is critical and HUD needs the ability to enter into contracts quickly and flexibly.
- Broaden HUD's loss mitigation techniques:
 1. Workouts should be pursued wherever possible. Often foreclosure is an expensive and inefficient solution. If foreclosure is pursued, the most HUD can expect to recover is 100 percent of the property's current value, less foreclosure costs and lost interest during the process. Workouts need to be done with this in mind. The current loan balance is interesting but irrelevant at this point. HUD could also benefit from having the flexibility to make a soft second mortgage for that portion of the loan balance that exceeds current loan value.
 2. HUD also needs the flexibility to invest new money in many of these properties. Often a \$1,000 - 2,000 unit investment in a property will generate far better results for HUD than foreclosure. Borrowers need to be motivated to invest new money into these projects.
 3. HUD should provide seller financing on its REO. Many properties have substantial deferred maintenance and also will need rehabilitation financing provided by HUD. These properties have construction and lease-up risk which a prudent private lender would not assume.
- HUD needs to alter borrower behavior. As such, it is important that HUD:
 1. Enforce remedies against general partners and management companies where there is fraud, waste, or continuing serious code violations;
 2. Require borrowers to replace poor property managers—particularly where the management company is a related entity;

3. Negotiate with borrowers on a portfolio basis don't foreclose on the severely distressed properties and leave the general partner with all the good projects;
4. Reduce property management fees to market rates.

Recognizing the need to assure that properties that have received government subsidies should remain affordable, Congress should continue to review the desirability of placing extensive and complicated restrictions on all multifamily properties in HUD's inventory as a condition for the disposition of the property. HUD should have the ability to take individual market conditions into account and establish affordability restrictions or subsidy assistance based on those conditions. It has been Freddie Mac's experience that in many markets, properties we have sold from our REO have rents affordable to low-income families. Rigid affordability restrictions inhibit the sale of troubled loans and foreclosed properties. Further, such restrictions can place HUD in a catch-22 of having to dispose of loans or properties without the subsidies to support that disposition. In this regard, I want to commend Congress for beginning to address this issue in the Multifamily Housing Property Disposition Reform Act of 1994, P.L. 103-233 (1994) enacted earlier this year. These reforms will help address the backlog in HUD's REO inventory.

Finally, I believe that in any future HUD multifamily programs, borrower and servicer interests need to be aligned with HUD's need for loans with long-term viability. In the past, large up-front fees and tax considerations motivated many new loans rather than long term viability of the project.

V. CONCLUSION

In conclusion, Mr. Chairman, there is no doubt that HUD has some serious problems in their portfolio and that they will be expensive to fix in the best of circumstances. However, I also believe that these problems are solvable. With strong asset management processes and skilled staff who are accountable for their decisions, HUD can reduce the government's losses by billions of dollars.

While much work remains to be done, many of the changes enacted by Congress earlier this year and the initiatives embarked upon by HUD are steps in the right direction and clearly demonstrate an increased understanding and commitment to addressing the problems in HUD's multifamily portfolio. There is no doubt, however, that these efforts are hampered by regulatory and statutory barriers. I again commend you and your subcommittee for your efforts in removing these barriers and determining the appropriate tools and strategies that are necessary before significant progress can be made.

Mr. PETERSON. Thank you.
Ms. Austin.

STATEMENT OF DEBORAH M. AUSTIN, DIRECTOR, LEGISLATION AND POLICY, NATIONAL LOW INCOME HOUSING COALITION

Ms. AUSTIN. Thank you, Mr. Chairman. My name is Deborah Austin. I appear today as director of legislation and policy of the National Low Income Housing Coalition. On behalf of the coalition's board, we want to thank you for this opportunity to present our views on the record.

We are pleased that the subcommittee has decided to continue its exploration of the challenges facing this troubled inventory. I think it is appropriate, however, to talk a little bit about the housing crisis that low-income Americans are facing before we speak directly to the crisis in the stock itself.

Currently there are approximately 5.5 million American households living in federally subsidized low-income housing. Unfortunately, for every low-income household now living in subsidized housing, there is another unassisted, very low-income renter household with a worst-case housing need.

Of the 5.5 million units that are subsidized, about 1½ million are subsidized with a project-based Section 8 program.

Our Nation has committed itself to addressing low-income housing needs with good reason. According to the 1990 census, one in 10 American families paid more than half of their income for rent. Just over 7 million renter households had income below 30 percent of the median income, and another 5.1 million had incomes between 31 percent and 50 percent of the area median.

Low-income renter households strongly related to strong housing burdens and housing problems; 58 percent of extremely low-income households have severe cost burdens, as do 23 percent of very low-income renters. In contrast, only 1 percent of moderate-income renters paid more than half of their income for rent.

Clearly, housing options for poor renter households are severely constrained by cost. And the most prevalent housing problem among these households is one of affordability.

There are approximately 20,000 projects produced through these Section 8 programs, which represents a scarce and a very precious resource that must be preserved to prevent us from falling backwards in our quest to solve our crisis.

The coalition is concerned that the growing negative media attention and the public policy dialog concerning the troubled assisted housing inventory will precipitate a rush to judgment about the wisdom of continuing project-based subsidies. Substantially meeting current unmet needs through income subsidies assumes the presence of those 1½ million units that are project assisted through Section 8.

Without this permanently affordable housing stock, the chances of low-income searchers finding units of adequate size and quality in many markets are substantially decreased.

If all project-based Section 8 were phased out in the State of New York, an additional 120,000 low-income households would have to find housing. If tenants opted to stay in their current neighbor-

hoods, a substantial number of these units would need to be located in New York City, which has one of the lowest residential vacancy rates in the country.

In addition to market absorption problems, heavy reliance on tenant-based subsidies to solve the problems of the distressed inventory has other difficulties. It assumes that the tenant based subsidy program under Section 8 does not face similar issues of housing quality violations, excessive rents in some markets, lacks inspection programs and resource shortages.

It focuses on immediate solutions for current tenants to the detriment of the housing needs of future income qualified tenants. Lastly, it does not provide a solution for the abandoned buildings and impact the communities that would be left behind if we would go to a total portable subsidy approach.

It has been estimated that nearly 25 percent of its stock is distressed. These projects represent a top priority for HUD intervention.

At the committee's hearing last time, Assistant Secretary Retsinas announced the formation of special SWAT teams which would be deployed to deal with the worst of the stock. We support this concept. However, while the Secretary should be complimented for the effort to assess the conditions, we are afraid this solution is a slow solution, something that could take some 30 years given what we know now about the resources that HUD has available and the number of projects that are in trouble.

For projects that have deteriorated to a point of presenting life-threatening hazards to their tenants, HUD has little choice but to seek receiverships or foreclosures. This places the properties under HUD's immediate control and allow rehabilitation and management services to be contracted out while new and responsible owners and managers are identified.

A policy driven solely by concern for the insurance fund is penny-wise and pound-foolish when it leaves thousands of residents on the line and inept housing providers are literally robbing the government of millions. Claims on the fund would eventually be mitigated by the prudent expenditure of dollars now appropriated and wasted in payments to owners who provide very little in return.

The Low-Income Housing Information Service is our affiliate who does our research, and they held a series of six public forums this year in partnership with local grassroots organizations and HUD to elicit input from residents of HUD assisted housing on the issue of expiring Section 8 contracts.

Through the forums, they met with over 1,000 tenants. While the information solicited was given in the context of questions about renewal of Section 8 contracts, it is instructive and sheds light on the issue of resident involvement in the workout of troubled properties, and the type of preservation strategies that would be supportive.

Opinions vary from State to State, although consensus emerged in several key areas. One, generally where HUD or owners elect not to renew a contract, residents do not find a tenant-based assistance is generally an acceptable solution.

Residents that we talked with favored a strong project-based preservation mandate. Generally in working through alternatives

for preservation and contract renewals, residents viewed involuntary displacement as a major threat and the least desirable option.

In the event that HUD or the owner seeks to transfer ownerships, residents, and resident-sponsored nonprofits should be given adequate opportunity and support to control and/or purchase those properties.

Tenants also felt that the presence of service coordinators were very important to their units and their project. They were valuable assets. As long as those coordinators were essentially residents themselves, resident input was sought on the coordinator's role and ongoing performance.

This information also sheds light on the issue of resident involvement on the issue of troubled properties.

In preparing for this hearing, I had the opportunity to talk with many residents who do live in troubled properties. I will not go through and recount those issues. But I will submit them for the record for your review in my testimony.

This year, in the course of the housing reauthorization process, we supported and lobbied for many legislative reforms to the Section 8 program which were included in either the House or the Senate versions of this year's bill. Unfortunately, it looks like that bill is not going to go forward. And we do commend the chairman for introducing a legislative proposal which picks up some of those reforms.

Our goals in the course of this reauthorization process were to create a strong preservation presumption which would preserve high-cost properties and economically diverse and gentrified neighborhoods; authorize the Secretary to exercise eminent domain powers to preserve projects that would otherwise be lost to the program; create strong antidisplacement protections; and authorize tenant inspections on request, tenant-initiated rent withholding, and repair and deduct rights for residents to enforce housing quality.

We supported the creation of a strong priority purchaser program so that tenants would be given the opportunity to purchase these projects and control them if they are lost through nonrenewal, and so the tenants could be involved in every step of the process. We sought strong relocation assistance for displaced tenants, and technical assistance to support tenant buy-outs.

Expanding civil money penalties giving HUD the authority to move project-based contracts to different projects, tenant rent withholding, and use of abated housing assistance payments to make repairs, all have the potential to improve HUD's enforcement and oversight.

The coalition would also support tax relief to owners, to facilitate transfers of ownership, if the transferees agree to use affordability restrictions for the remaining useful life of these projects.

None of these options provide the kind of immediate relief that is needed to remedy particularly severe conditions. Unfortunately, as you said, the housing bill is unlikely to be enacted in the near future and the problems are still with us now.

We urge this committee to set as its highest priority the use of its influence and authority to implement a funding system that is

sufficient to address the most urgent rehabilitation and security needs in the stock.

All congressional committees with jurisdiction over HUD operations and budget, including appropriations and budget committees, must join to establish and implement this priority. It is not enough to call for investigations and analysis unless all involved are willing to back up their statements of concern with the power of the purse. Otherwise the program and the people who depend on them for their homes will be left vulnerable to a never-ending series of media attacks and political postures with devastating ramifications.

I am very supportive for the call for a summit on this issue to raise the level of dialog and concern in the Congress and the administration regarding these project.

I will close my statement right now and thank you very much for the opportunity.

[The prepared statement of Ms. Austin follows:]

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Karen V. Hill, *Chair*

Cushing N. Dolbear, *President*

Dealing With Troubled Section 8 Housing

Statement of Deborah M. Austin, Director of Legislation and Policy, before the Subcommittee on Housing, Aviation and Employment, Committee on Government Operations, U.S. House of Representatives, October 6, 1994.

Mr. Chairman, members of the Subcommittee, my name is Deborah Austin, I appear today as Director of Legislation and Policy of the National Low Income Housing Coalition ("NLIHC"). The Coalition is a nonpartisan, nonprofit information and advocacy organization. Our members include low income residents, community-based nonprofit organizations, public agencies and other housing providers. The Coalition is governed by an elected Board of Directors from across the country, which meets twice a year to review and set policies for the group. The Coalition is affiliated with the Low Income Housing Information Service, ("LIHIS") a nonprofit public education, policy development and research group.

On behalf of the Coalition's board and members throughout the country, I want to thank the Chairman for giving us the opportunity share our views. We are pleased that the Subcommittee has decided to continue its exploration of the challenges facing the Department of Housing and Urban Development, owners and residents of the distressed inventory. We think it appropriate to preface our remarks with a few comments that highlight the housing crisis facing many low income Americans, and the pitfalls of abandoning these project-based approaches in favor of portable tenant-based subsidies.

I. Housing Needs and Federal Housing Assistance

Currently, there are approximately 5.5 million American households living in federally subsidized low income housing. Most live in housing subsidized by the Department of Housing and Urban Development (HUD), but about 500,000 live in housing subsidized through the rural housing programs of the Farmer's Home Administration. These units are the total amount of housing achieved by federal low income housing programs over more than half a century, beginning with the emergency and public housing programs launched in the depression of the 1930's.

Unfortunately, for every low income household now living in subsidized housing, there is another unassisted very low income renter household with a "worst case" housing need. Of the 5.5 million units of subsidized housing, about 1.5 million are subsidized through project-based Section 8 assistance.

Our nation has committed itself to addressing low income housing need with good reason. According to the 1990 census, one in ten American families paid more than half of their income for rent. Just over seven million renter households had incomes below 30% of median ("extremely low income"), and another 5.1 million had income between 31% and 50%. Low renter income is strongly related to severe housing cost burdens. Among renters,

58% of extremely low income households had severe cost burdens, as did 23% of very low income renters. In contrast, only 1% of moderate income renters paid more than half of income for rent. Clearly, housing options for poor renter households are severely constrained by costs and the most prevalent housing problem among households with "worst case" housing needs is one of affordability, rather than substandard conditions or overcrowding. The approximately 20,000 projects produced through the New Construction, Substantial and Moderate Rehabilitation, Section 8 programs during the 1970's and 1980's represent a precious and scarce resource that must be preserved to prevent us from falling backward in our quest to solve America's housing crisis.

II. The Project-based Option Should Be Retained

The National Low Income Housing Coalition is concerned that the growing negative media attention and the public policy dialogue concerning the troubled assisted housing inventory will precipitate a rush to judgement about the wisdom of continuing Section 8 project-based subsidies.

Substantially meeting unmet needs through income subsidies, assumes the presence of the 1.5 million units currently receiving a project-based subsidy through Section 8. Without this permanently affordable housing stock, the chances of all low income searchers finding units of adequate size and quality in many markets are substantially decreased.

If all project-based Section 8 were phased out in the State of New York, an additional 120,000 low income households would have to find housing. If tenants opted to stay in their current neighborhoods, a substantial number of these units would need to be located in New York City which has one of the lowest residential rental vacancy rates in the country. In addition to market absorption problems, heavy reliance on tenant-based subsidies to solve the problems of the distressed inventory faces other problems;

- It assumes that the tenant-based subsidy program does not face similar issues of housing quality violations, excessive rents, lax inspection programs and resource shortages,
- It focuses on immediate solutions for current tenants to the detriment of the housing needs of future income qualified tenants; and
- It does not provide a solution for the abandoned buildings and impacted communities that would be left behind. By failing to preserve these buildings, it will contribute to cycles of decay and abandonment.

III. Severely Distressed Projects: Resident Needs Must Be Protected

It has been estimated that nearly 25% of the stock is distressed. These projects represent a top priority for HUD intervention. At the Committee's last hearing Asst Secretary Retsinas announced the formation of special SWAT teams which would be deployed to deal with the worst of the troubled stock. They would target 60 or 70 projects annually. Assuming only 10% of the units fall in that category, it could take 30 years using current resources to make an impact in the 2,000 projects which are most extremely

distressed. While the Asst. Secretary should be complimented for the effort so far to assess the condition of the stock, and craft a response, a 30 year solution for residents living in barely habitable dwellings is clearly unacceptable.

What are the answers?

For projects that have deteriorated to the point of presenting life threatening hazards to their tenants, HUD has little choice but to seek receiverships or foreclosures. These options place the properties under HUD's immediate control and allow rehab and management services to be contracted out while new and responsible owners and managers are identified. A policy driven only by concern for the FHA insurance fund is penny wise and pound foolish, when the lives of thousands of residents are on the line and inept or unmotivated housing providers are literally robbing the government of millions. Ideally, dollars lost to the government through claims on the fund, would eventually be mitigated by the prudent expenditure of dollars now appropriated and wasted in payments to owners who provide very little in return.

The Low Income Housing Information Service, held a series of six public forums this year in partnership with local grassroots organizations and HUD, to elicit input from residents of HUD assisted housing on the issue of expiring Section 8 contracts. Through the forums, LIHIS met with over 1,000 tenants. While the information solicited was given in the context of questions about renewal of Section 8 contracts, it is instructive and sheds light on the issue of resident involvement in the workout of troubled properties and the type of preservation strategies that would be supported. Although opinions varied from state to state, a consensus emerged in several key areas.

- Generally, where HUD or owners elect not to renew a Section 8 contract, residents do not find that tenant-based assistance is an acceptable solution. Residents favor a strong project-based preservation mandate. Generally, in working through alternatives for preservation and contract renewal, residents view involuntary displacement as a major threat and the least desirable option,
- In the event that HUD or the owner seek to transfer ownership, residents and resident sponsored non-profits should be given adequate opportunity and support to control and/or purchase the property, and
- Tenants felt that project Service Coordinators were a valuable asset to the project so long as (1) those coordinators were residents, (2) resident input was sought on the Coordinator's role and ongoing performance and (3) Coordinators were not used to create barriers between the tenants and management or otherwise interfere with resident organizing activities.

This information also sheds light on the issue of resident involvement in the workout of troubled properties and the type of preservation strategies that should be supported.

In preparing for this hearing, I had the opportunity to speak with tenant representatives and tenant organizers regarding the conditions residents face in troubled projects. Tenant organizers for Jose de Diego in Bronx New York, noted that the eight buildings in the complex have more than 3,000 outstanding housing quality violations, 500 of which pose immediate threats to tenant safety. It should be noted that tenant caused damages and

vandalism can not be blamed for the failure of major systems like elevators, roofs and plumbing. At this project, tenants have consistently complained about elevators which do not work. Tragically, last year an 8 year old boy fell to his death down an elevator shaft. Yet, the problems persist today.

The management at Jose de Diego has promised to take care of "certified" violations and has embarked upon a lengthy and vague process to determine which of the 1,200 violations are certifiable. Although tenant representatives are scheduled to meet with management, management has not provided information regarding the repair schedule and the procedures for making effective complaints despite their promise to deliver the information over a month ago. Jose de Diego Beekman is 100% Section 8 and receives 9 million dollars a year in housing subsidies. Can HUD exercise no oversight here?

Holiday Lakes Apartments in Pompano Beach, Florida, has a long and tortured history of awful conditions and bad management. Artie Jackson, a tenant leader at the complex placed much of the details about Holiday Lakes in the record at the Subcommittee's hearing on July 26. I will not recite the horror stories (including the death of a child resulting from improper maintenance of the exterior grounds) a second time. Suffice it to say that, despite the Department's desire to work with the current managers, the tenants have decided that their interests would be best served by getting a new owner/manager to the site and have sued in federal court to compel HUD to do so. Why doesn't HUD facilitate a more constructive role for resident involvement in the turn-around of this project?

NLIHC supported and lobbied for many of the legislative reforms in the Section 8 program which were included in either the House or the Senate versions of this year's housing reauthorization bill. Working in a coordinated effort with the National Alliance of HUD Tenants (NAHT) and the National Housing Law Project (NHLP), we mounted a comprehensive pro-tenant advocacy agenda around the issue of expiring Section 8 contracts. Again, these issues are relevant to questions surrounding tenant involvement in decisions regarding distressed projects. Our goals were to

- Create a strong preservation presumption, which would preserve high cost properties in economically diverse and gentrifying neighborhoods,
- Authorize the Secretary to exercise eminent domain powers to preserve properties that would otherwise would be lost to the program,
- Create strong anti-displacement protections,
- Authorize tenant inspections on request, tenant-initiated rent withholding and repair-and-deduct rights for residents to enforce housing quality,
- Create a strong priority purchaser program so that tenants would be given the opportunity to purchase and control projects lost through non-renewal to inform and involve tenants at every step of the renewal process, and
- Provide relocation assistance for displaced tenants and technical assistance to support tenant sponsored buyouts.

Expanding civil money penalties, giving HUD the authority to move project-based contracts to differing projects, tenant rent withholding and use of abated housing assistance payments to make repairs, all have the potential to improve HUD's enforcement and oversight. The Coalition would also support tax relief to owners to facilitate transfers of ownership if the transferees agree to use and affordability restrictions for the remaining useful life of the project and tenants are consulted in the process. None of these options however, provide the kind of immediate relief that is needed to remedy particularly severe conditions. Unfortunately, the housing bill is unlikely to be enacted in the near future and a truly comprehensive effort will require more money than the department currently has available.

We urge this committee to set as its highest priority, the use of its influence and authority to implement a funding system that is sufficient to address the most urgent rehab and security needs in the stock. All Congressional committees with jurisdiction over HUD operations and budget, including the Appropriations and Budget Committees must join to establish and implement this priority. It is not enough to call for investigations and analysis unless all involved are willing to back up their statements of concern with the power of the purse. Otherwise, the program and the people who depend on for their homes will be left vulnerable to a never ending series of media attacks and political posturing with devastating ramifications.

We agree with HUD that a glaring deficiency in the program is the absence of a comprehensive capital grants program. It is unthinkable that a bureaucracy charged with oversight and enforcement of housing quality standards in 1.5 million aging units is without an adequate reserve of flexible rehab funds to make the program work. By 1998, it is estimated that the cost of renewing Section 8 contracts alone will use up to one-fourth of HUD's entire budget authority. When we arrive at this precipice, we will need to point to a well managed and financially healthy inventory that is providing good housing and strong communities for low income Americans or risk irreparably damaging the public's trust in the government, industry and advocates' ability to deliver.

IV. HUD Should Work with Residents to Move Beyond Crisis Management

The Department needs more resources to get at the worst conditions in its troubled stock. However, a major attitudinal shift toward residents is also in order. The goodwill and openness that is often expressed at HUD headquarters toward resident concerns and initiatives is a far cry from the anti-tenant attitudes that permeate many of the regional and area field offices. If ever a bottoms-up solution was called for it is in the area of tenant/HUD relations. The huge gap between pro-tenant rhetoric in Washington and the hostility and suspicion residents face when dealing with HUD field staff must be closed. Given current fiscal constraints, these residents represent more than HUD customers or clients. They are themselves a potential resource to HUD in monitoring and enforcing quality standards, devising comprehensive solutions for distressed projects and stabilizing buildings that are in a downward spiral.

We recommend that the Department develop a comprehensive set of reforms, aimed at involving residents in the dialogue and decisions about the management and preservation of this stock. Proposals to implement such a reform were jointly submitted two years ago by the Low Income Housing Information Service and the National Alliance of HUD Tenants. An excerpt from the full set of recommendations is attached as Appendix 1 to this statement.

V. Highlighting the Good Projects: Sharing Success

We consider it equally important for the subcommittee and HUD to highlight successes as well as to analyze failures. NLIHC is currently circulating a short questionnaire to members and allies to determine where the program seems to be working effectively. We plan to do follow up calls and expand this information. HUD could certainly benefit from building its understanding of the owners and managers who have a track record for well run projects (especially older family buildings) and identifying areas where its own area offices are exercising proper oversight. Building models and replicating success are key ingredients for long term support of the Section 8 Project-Based program. We will be glad to share our findings with the Subcommittee as we develop our report on the surveys.

Thank you for the opportunity to share our views.

Deborah Austin
Director of Legislation & Policy

Excerpts from the 1992 joint LIHIS/NAHT Recommendations to HUD

I. Adopt a HUD Tenant Bill of Rights to End Owner Harassment of Tenant Organizations and Protect the Right to Organize

Harassment by owners/managers of tenant organizations and individual tenants who assert their rights is almost universal in HUD housing across the country. HUD has done very little to combat the pervasive climate of fear and intimidation that afflicts tens of thousands of low income people and inhibits resident aspirations to own or otherwise take charge of their lives; in fact, many HUD staff have added to this problem by hostile or indifferent responses to tenant representatives. We strongly urge a concerted approach by HUD at all levels to end this profoundly un-American environment in housing aided by HUD funds.

In particular, HUD should act at once to end these practices in buildings which it directly manages.

1) Adopt Just Cause for Evictions and Right to Withhold Rent. HUD should amend leases to specify that evictions can only be made for specified, "just causes", such as non-payment of rent, disturbance of other people's rights, proven criminal activity, etc. Retaliatory evictions for exercising tenant rights should be clearly prohibited in the lease and in HUD policy.

HUD should also recognize a tenant's right to withhold rent (including the Total Tenant Payment in Section 8 units) for substandard conditions and to "repair and deduct" from rent, with proper notice. A finding by a HUD inspector of non-compliance should constitute one definition that substandard conditions exist.

2) Publicize tenants rights and the right to organize. HUD should notify, in plain and appropriate language, every tenant of their basic rights, including steps residents can take to enforce them. This notice should also identify responsibilities of owners and managers (such as maintaining waiting lists, transfers, etc.) and provide phone numbers of HUD staff, enforcement agencies, and local tenant and legal service organizations who can help.

HUD should also notify residents, and post notices in buildings, of their right to organize and otherwise assert their rights. A revised version of Secretary Kemp's memo on this topic should be posted and sent to all residents.

HUD's standard Lease should be revised to include a statement of each tenants legal rights, including the right to organize. Leases should be provided in appropriate languages to residents.

HUD's Resident Initiative staff should conduct workshops for tenants on tenant rights, HUD policy and procedures, including the Comprehensive Multifamily Service Policy.

3) Notify owners of their obligation to respect tenants rights. HUD should notify owners and managers of the right of tenants to organize and assert individual rights and specify that violations are grounds for termination, default or civil monetary penalties, particularly in HUD-owned or held buildings which HUD itself manages. Memo should state that HUD is aware that this is a problem. The notice should specifically state the types of actions which constitute harassment, including:

- a) Denying residents free, accessible meeting space.
- b) Sending management representatives to tenant meeting unless specifically requested by the tenants organization.
- c) Allowing management employees or contractors to run for office in the tenants organization.
- d) Evicting, threatening to evict, withholding entitlements (such as qualified transfers), or otherwise penalizing residents for organizing or asserting their rights
- e) Attempting to adversely influence resident leaders by offering individual inducements such as employment, preferential transfers or vacancies, rent abatements, favored repairs, or other benefits not available to all residents in the development.
- f) Attempting to form a competing residents organization under the control of the management company or owner.

HUD should notify owners of their obligation to provide free, accessible community space for use by residents and resident groups

4) Penalize owners who violate tenants rights. HUD should severely penalize managers who undermine tenant rights as specified above. HUD should issue a notice to HUD staff specifying penalties including removal of management agent, default, civil monetary penalties, debarment and limited denial of participation and instructing HUD Field Staff to include an assessment of these issues as part of HUD management reviews. HUD's Resident Initiative staff should be assigned specific responsibilities to implement these policies and respond to tenant complaints.

HUD should further define Indicator 10 of Attachment 1 of the Comprehensive Multifamily Service Policy, to include the above examples of tenant harassment as "Indicators of Troubled Projects" requiring prioritization by HUD staff.

In HUD-owned or held buildings which HUD itself manages, HUD should terminate management agents who violate tenants rights.

5) Prohibit HUD property managers from purchasing HUD buildings. To minimize incentives for managers to unduly influence or undermine resident groups or leaders, HUD should restore the prohibition on property managers or contractors employed by HUD from owning, or participating in ownership, of HUD buildings after Property Disposition.

6) Upgrade standards for independent tenant organizations. The Salamone Memorandum (9/4/91) regarding "Resident Initiatives in Multifamily Property Disposition" should be amended to add the following additional requirements to ensure the integrity and independence of resident organizations seeking negotiated sales:

- a) demonstrated independent, "arms-length" relationship to management company
- b) By-Laws which prohibit employees of management agents or contractors from serving as officers of the residents organization.

4) Guarantee right of residents to comment, and HUD response. Allow residents or resident representatives to comment on, and require HUD to respond in writing to specific resident comments, on the documents listed above.

Guarantee a meeting with appropriate HUD officials regarding any potential major decision affecting their building to a resident groups which requests it, prior to the decision being made.

5) Allow tenant participation in selection/removal of managers. Tenants should be partners with HUD in reviewing management performance under the CMSP. HUD should establish a grievance process for residents to seek removal and other sanctions against managers of their developments

Require notice and review by residents and groups when management contracts in multifamily housing are up for renewal at least three months prior to expiration. Residents should be allowed to comment on renewal to owners and HUD. Owners and HUD should be required to respond in writing.

Allow resident organizations to advise HUD on the selection of an interim management agent from HUD's Source List when HUD becomes MIP, prior to selection

Apply President Bush's proposal, to allow public housing resident groups to replace managers, to privately-owned HUD-assisted properties as well

6) Improve and clarify enforcement options. Publish a notice setting specific standards for penalties in addition to default, including removal of management agent, area or national debarment, limited denial of participation, and issuance of specific civil monetary penalties pursuant to 24 CFR Part 30.

HUD should clarify that the following actions by owner/managers will be subject to penalties. Form HUD-9834, Management Review Report, should be upgraded to include a detailed, specific assessment of performance on these items:

- a) Violation or undermining the right of tenants to organize or utilize their rights (see list above, II(3))
- b) Failure to follow HUD requirements for tenant transfers, filling vacancies from the waiting list, or recertifications
- c) Selling of apartments or other leasing irregularities
- d) Discriminatory practices
- e) Unauthorized TPA's
- f) Failure to take reasonable steps to eliminate illegal drug-related activity from the property
- e) Failure to comply with local laws governing landlord/tenant relations (for example, regarding security deposits, improper penalties and fees, etc.)

Establish greater flexibility in HUD enforcement of Section 8 contracts to allow partial withholding of federal government share and/or direct payment of third parties for a building whose owner/manager is in non-compliance.

Where HUD inspections conclude there are violations in specific units and owners have failed to correct them in a timely manner, HUD shall withhold the federal government's share of rent for that unit until the violation is corrected.

HUD should disclose upon request the general standards defined by each Field Office of what constitutes "serious deficiencies" and the "waste" provision of the mortgage under applicable state law, and allow public comment on the Office's findings implement these policies and respond to tenant complaints.

7) Enlist tenants as partners in enforcement. HUD should enlist tenants as partners to enforce the CMSP. HUD should clarify that residents and resident organizations have standing to sue in federal court to enforce HUD standards and contracts against non-performing owners/managers.

Mr. PETERSON. Thank you. I appreciate you being with us.

Ms. FITTS. That is OK.

Mr. PETERSON. I want to say something that may not be too popular, but I think it needs to be said, and I will get your reaction.

One of the problems is that we have a disconnect with this program in that it doesn't require people to live up to their responsibilities, or the market can't work because it is really disconnected, both on the landlord side and to some extent on the tenant side. I wonder if you would agree with that. You are arguing we ought to maintain the stock, and I think everybody agrees with that.

The problem is that a lot of the stock is not working. We do not have the money to fix it under the current program. And frankly, I think the landlords in certain of these circumstances are a big part of the problem, but I think we also have tenants that are part of the problem. And I don't know how we get at that.

We are as a government providing a significant amount of subsidy and benefit for these tenants, and certainly in these circumstances they do not take the responsibility of doing their part in keeping that unit. So I think we have got problems on all of these different sides. I don't know how we get at it, because this is a small minority of landlords, it is probably a small minority of tenants.

But it is causing problems for everybody in the whole system. Is your group looking at that end of things? Do you have any ideas on how we can empower tenants?

Ms. AUSTIN. With the residents I have talked with, the complaints that they have expressed to me are not the kind of complaints that are generally caused by tenant-caused damages. Elevators, plumbing, major systems, exterior parameter fences left in disrepair; that is generally not brought on by tenant vandalism.

Mr. PETERSON. Once a project gets to a certain level it really starts to deteriorate and you get tenant problems. And I think that is where we are with some of these projects.

Mr. COMEAU. But, Mr. Chairman, in a well-maintained property, the tenants won't damage the property.

Mr. PETERSON. It is kind of a chicken and egg thing.

Mr. COMEAU. That is right. What happens in the Section 8 properties, if you have a property that is not Section 8 and is not being well maintained, people will leave it and go someplace else, or if they choose to stay, they will stay and they may destroy the property.

In the project-based Section 8, they don't have an option so they are forced to stay and they take it out on the building.

Mr. PETERSON. And so given that we have that situation in certain of these properties, I think that is where the push is coming to eliminate this program, because people see this going on.

How do we resolve that? We aren't going to figure that out here today, but I think I am attracted to the idea of turning this whole thing more to a market-oriented situation where the people's action has some impact on themselves, that they have to have some responsibility in all this, whether they are landlords, whether they are tenants, whether it is us on the government side of things.

And the problem with this system, is that there is no responsibility. They don't have to take responsibility for their actions at some point in this program. Somehow or other we have to change that.

Ms. AUSTIN. Mr. Chairman, I would just like to add that part of what can happen is to start to gather and look at the good properties. And you had an excellent example of a well-managed property at your last hearing. And to develop some models.

How do those managers work? How do those residents live and carry forth their responsibilities as residents?

I think will you find there is quite a bit of that going on. But you have to have a fundamental commitment to the idea, notion of developing and nurturing a low-income, working-class project, community, and making that work. And most residents are very interested in getting involved. They want to see their communities turned around.

Mr. PETERSON. I have visited them. I am aware of that. You were talking about the Section 8 that was project based and the Section 8 that was vouched.

Ms. FITTS. Yes. Let me make two suggestions. First of all, I want to emphasize that I don't think there is enough money in the Federal budget to immediately pay for housing for every low and moderate-income American who needs it. I will tell you that I do not think that the problem of fixing this portfolio has anything to do with money. I think there is plenty of money.

If you look at the current expenditures that will be paid for this portfolio, I think the problem is the rules you use to apply to that money, I think if you say we are not going to upset one property manager, we are not going to upset one tenant, we are not going to upset one constituent, then, yes, the only way you will solve it is with more money.

Mr. PETERSON. That is what we have now.

Ms. FITTS. But the conventional wisdom that there is not enough money is false.

Mr. PETERSON. Under the current circumstances there is not enough money.

Ms. FITTS. Under the current rulings. But I submit to you that throwing money at the problem will not solve it. Let me give you an example.

Today a substantial amount of money is spent on project-based Section 8 to make sure that the debt on that project—

Mr. PETERSON. Is paid.

Ms. FITTS. Is paid. Now, if FHA was a private financial institution, under the rules that this Congress applies to Citicorp or any reasonable financial institution in this country, they are required by law and regulation to recognize the fact that that debt is worthless and should be written down.

The refusal to write that debt down does two things. It forces this waste of project-based subsidy, and it permits a situation where an entire bureaucracy at HUD who would like to fix the problem cannot do it, because they are not allowed to face the kind of markdown that is they have to take in the FHA fund to get the problem fixed.

So it gets back to rules. To the extent that the U.S. Congress is willing to apply the same rules to their own balance sheet that

they have required the S&L industry and the private financial markets to, the problem can be fixed.

Mr. PETERSON. But if you start doing that you are probably going to be displacing some low-income residents. You will have groups coming in arguing not to do that because they are going to be afraid they are going to lose the properties.

Ms. FITTS. I think you will have many groups arguing not to do it, but I don't think you need to displace one tenant.

Mr. PETERSON. I agree with you. But you will get people coming in objecting to it.

Ms. FITTS. Absolutely.

Mr. PETERSON. That is how we got to this situation.

Ms. FITTS. Well, but the Congress has to decide what is the criteria: To fix the portfolio or keep everybody happy.

Mr. PETERSON. I agree. What do you want to do, Mrs. Thurman? Do you want to fix this?

Mrs. THURMAN. I think I want to fix it.

In your testimony, you have attached I guess it is a bill of rights or appendix to this, and you have suggested this had actually been given to Congress 2 years ago. Was there ever any discussion about it?

Ms. AUSTIN. Actually, no, there was a hearing on the troubled inventory 2 years ago, and so this was entered into the record at that time, and we, as a part of our regular round of meetings with members of the Banking Committee and so forth, have raised these issues pretty consistently. National Alliance of HUD Tenants has had lots of meetings with HUD and others on the Hill regarding these issues. So the dialog has been ongoing.

Mrs. THURMAN. One of the things that I found interesting in the testimony, not only from you all, but also the group before us, was that there always seems to be this concern that what is happening in Washington is not getting into the HUD regional offices.

Could any of you give us some ideas other than maybe the computer data system that can help us straighten those out? Because it is not just in HUD. It seems to be in just about every agency.

Ms. FITTS. I would like to address that, because I think one of the solutions is not to make the people at HUD work harder and try more. A Federal agency in the 1990's cannot possibly be in the business of local individual project business.

If you look at what is happening to General Motors, IBM, if you walk into any bookstore in America, you see books that say, reengineer, reengineer, and what that means is let's redefine and let everybody do what they are good at.

What HUD is good at is providing credit enhancement and subsidy on scale in very efficient ways. But what they are not good at is asset management in 25,000 different markets across America, because to be responsive to a local community you have to be part of that local community.

And so frankly, as the Inspector General mentioned, you have got to reengineer these programs so that you have somebody managing, and frankly it can't be HUD. You cannot have a Federal bureaucracy being entrepreneurial and quick, because if you show me at entrepreneurial government at a Federal level, I will show you

a corrupt government at a Federal level. But that is what you will need if you want to be responsible to tenants in local markets.

I assure you, you can never set up enough systems or phone banks or 800 numbers at HUD to be responsive to all those people.

Ms. AUSTIN. I would agree with that, that there does need to be a retooling at the local level. But what I mentioned in the statement is an attitudinal shift which I think is something HUD can accomplish by reaching out and letting the field know that this is a new day, that residents are welcomed at area offices, that residents are partners in this process.

So that is a little separate from the actual management and operational shift that has to happen, to really get the bureaucracy out, its tentacles out into each individual project.

Mrs. THURMAN. Also in your testimony, and it is kind of scary, but—and you skipped over it, was the conversation about what has happened where I guess a child had died from going down an elevator shaft, and then in my home State in Florida there was an area where two children actually have died.

Tell me what happens with this kind of a situation. I mean, they take it to somebody, and it just falls on deaf ears, or does anybody come out and investigate, does anybody look at it, are there any violations?

Ms. AUSTIN. The situation in Florida, counsel has been retained to try to enforce—well, try to compel the transfer of ownership at that property. That is my understanding of the current status of it. There is a suit pending in Federal Court.

I think tenants are demoralized in some of these instances, but they do make their voice heard to the best of their abilities. In many instances you have owners who are really absentee owners, managers and owners who aren't working in close coordination with one another. So you just have a structural situation that is not responsive to what is going on in these tenants' lives from day-to-day.

Mrs. THURMAN. Thank you.

Mr. PETERSON. Well, we are getting close. You have all provided some good information. I think we do need to get everybody together in a room and come to some resolution. Because we clearly have some folks trying to do one thing in this program and some folks are trying to do another, and they are not working the way they should.

And if we could get the tenants to have some ownership in this and have some involvement and to feel that they are being listened to, I think that would solve a lot of these problems. If they feel that this is part of their deal and that they have some ownership in it, they could solve a lot of the problems in those buildings and projects themselves, if they have the way to do it.

But I agree, I don't think HUD can do this. We can maybe structure the system.

One last thing on this computer business. At one of our hearings we talked about this early on with HUD after I got here, the fact that they have seven systems and they can't talk to each other. As far as I understand, they are now creating an eighth system that won't be able to talk to the other seven or anybody else.

I am not sure why that happens, because GSA gets involved in this or what. But this isn't unique to HUD. It seems like every agency gets into this quagmire. We would be better off if we gave every government employee a budget of \$2,000 and told them to go to Radio Shack. We would end up with a more efficient system.

Ms. FITTS. The one immediate thing you could do is to write to the Secretary and ask him why the system's responsibility for housing and FHA is in a different department which doesn't coordinate or report to the FHA commissioner, and why, in a world where these services can be provided at very low cost, a system cannot be put in that is PC-based?

Mr. PETERSON. We asked him that at that other hearing. I am not sure we got any good answer other than they had formed this committee and the committee decided that they should do this this way.

Ms. FITTS. Mr. Chairman, this is a problem—if this committee could do one thing to fix this quickly, this is the single most important thing. It is within the department's control. But it requires changes in delegations of responsibility. And it requires a recognition by a system that has tremendous vested interests in mainframes. We are in a PC-based world.

Mr. PETERSON. We were 5 years ago.

Ms. FITTS. How right you are. And this must be done.

Mr. PETERSON. I think we told them that at this other hearing. It didn't have any effect. But it is not just HUD. The Agriculture Department is in the same shape. FAA, to a certain extent—they all are in this quagmire. And they always blame somebody else. When you talk to them, they say GSA has these requirements and they have to go through this bidding process. I think the best thing we could do is say the GSA cannot have anything to do with computers.

Mrs. THURMAN. Austin, when you were there, had you made some of these same kind of recommendations as well that you are making to us today?

Ms. FITTS. Yes, there are three things we did which now give the FHA and the HUD the ability to do many things the other agencies can't do, and frankly are an opportunity for this committee. The first thing we did was we found a way—and frankly had to go to the White House to get the permission. We walked in the door and found 7,000 people with 100 computers and within 18 months had made provisions, and I think it took about 24 months, 7,000 people all had 286 PCs which were networked.

Is it enough? No, because many of them, to the field system, have to run through the mainframe.

What that has done is that has radically changed the speed with which that bureaucracy can move. But again, under current constraints.

Mr. PETERSON. Where were these computers? Over in the main office here?

Ms. FITTS. No, every employee of the FHA, all 7,000 field and headquarters. So one portion of HUD and I believe the other departments are. But I can't speak to that.

The second thing we did was we persuaded OMB to require all the Federal credit programs, but including the ones at HUD, to

have annual outside audited financial statements and actuarial studies. Those studies gave us the ability to start to find out, you know, what the economics and therefore what the choices for policymakers were, which we had no idea, and took months to find out.

Now, that is not enough. But if you create the kind of senior asset management talent that you must have internal, it must be internal, and you give them the tools with a very frankly extremely inexpensive PC-based system nationwide, you can start to provide to this committee the kind of highly specific recommendations you have asked for today that can change this. And I think you would be stunned if you knew how mundane some of them were.

Mr. PETERSON. I understand how it can be done. I am very skeptical that it will ever get through the bureaucracy. The software is there. This is not rocket science. All you need is a modem and you can hook everybody up. But I will guarantee you if you go over there and try to tell them, by the time you get done they will have some huge convoluted deal set up, and it gets screwed up.

Ms. FITTS. I will tell you, Mr. Chairman, first of all I think the bureaucracy that I worked with—and I can only speak to one portion of the department—is filled with many wonderful, talented people who would love to fix this. Frankly, one of the advantages they developed when they got the PCs, inadequate as they are, is they just started to fix it in complete defiance of the political appointees, which frankly I have to tell you is not such a bad thing.

So I think that there are many portions of the bureaucracy that would love to do this and would do just a fine job.

Mr. COMEAU. At Freddie Mac—

Mr. PETERSON. I agree with that. If they were left to their own devices, they would do the right thing. I just think somebody will get in the way to stop them. That is what I think will happen.

Ms. FITTS. Absolutely.

Mr. COMEAU. It can be done, and at Freddie Mac we started from scratch and developed probably the most sophisticated management information system in about 6 months. So—

Mr. PETERSON. Did you have anything in place?

Mr. COMEAU. As Austin said, it was archaic. And so it was basically going from scratch and going to PC-based systems that are all linked together and talking together.

Mr. PETERSON. I know it is not hard to do.

Ms. AUSTIN. Now is a great opportunity, with Nic Retsinas and Helen Dunlap at the helm, two very talented people. Helen Dunlap has a great track record in working with residents. We have had many dialogs with her office this year.

With that kind of talent at the top, there are some barriers that can be removed very quickly if the capacity and resources are provided to the department.

Ms. FITTS. One last thing, Mr. Chairman. One of the reasons that the leadership at HUD has not come forward with many of the specifics that we are talking about today, perhaps at the speed which you would like, is they have implemented a restructuring initiative. I think they have done it the right way, and their goal is by the end of the year to come forward with alternatives and options and recommendations as to how a piece of the agency, the one

that does this, can be reengineered—programs, organizations, structure—to start to be able to efficiently deliver the congressional mission. And I think that this portfolio is an important piece of that.

And what this committee can do, whether it is PCs or other things, is look at that definitive list from the people who really have the responsibility and the information and try to be as supportive as they possibly can.

Mrs. THURMAN. Then in the suggestion we made of kind of having the summit toward the end of the year and bringing all the parties together, then we believe this would be a good timing based on what you have just said here today.

Ms. FITTS. Yes, but in the meantime I would hold OMB accountable. If I were the American taxpayer, and I am, and we are talking about a portfolio—just the insured portion is approximately \$35 billion—I would want to know what excuse there was that a \$10 million investment in PCs was not possible.

Now, OMB can fix that if they want to. That is easy.

Mr. PETERSON. They can do it without any legislative authority?

Ms. FITTS. Mr. Chairman, they can—if you were at HUD, they can do anything to you. They can certainly make you put in \$10 million of PCs.

Mr. PETERSON. The money is there in the budget. They just have to rearrange it.

Ms. FITTS. And you have to understand, with respect to the insured portfolio, that there is legislative authority to fund these things out of the fund. The budget cap on that is an issue, and I think should be addressed at the time of the restructuring.

Mr. PETERSON. Well, thank you all very much. We appreciate it. Thank you all for being with us.

The subcommittee is adjourned.

[Whereupon, at 11:15 a.m., the subcommittee was adjourned, to reconvene subject to the call of the Chair.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

U. S. Department of Housing and Urban Development
Washington, D C. 20410-4500

August 4, 1994



OFFICE OF INSPECTOR GENERAL

Honorable Collin C. Peterson
Chairman, Subcommittee on Employment,
Housing and Aviation
Committee on Government Operations
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is to follow up on two matters which were discussed during the July 26 hearing on Section 8 project-based housing. The specific matters that need clarification are the extent to which civil money penalties have been assessed on multifamily property owners and the status of HUD's proposed rule on rent comparability studies.

Civil Money Penalties

During the hearing, I testified that I had been advised by HUD's Office of General Counsel that, to date, no civil money penalties have been assessed on property owners. However, Helen Dunlap, Deputy Assistant Secretary for Multifamily Housing Programs, stated during the hearing that civil money penalties had been collected from two owners.

I was referring to HUD's authority to assess "civil money penalties" against project owners pursuant to Title I, Subtitle A, Sections 108 and 109, of the Department of Housing and Urban Development Reform Act of 1989. After further examination, we have found that no such penalties have been assessed upon or collected from multifamily project owners.

In her testimony, Ms. Dunlap was referring to two cases involving multifamily project owners that my staff audited. In both cases, we reported significant amounts of funds diverted from the projects. For the first case, we reported about \$8 million in diversions of project funds. In addition to recommending recovery of the misspent funds, we referred the case to HUD's Office of Housing in April 1993 for its assessment of civil money penalties against the agent/owner for violating applicable HUD regulations. In May 1994, the Office of Housing responded to our referral by indicating that this case was settled and that civil money penalties were no longer appropriate. The settlement referred to by the Office of Housing would involve the repayment of \$8.2 million to the projects and \$1.33 million to HUD if the proposed Repayment Agreement receives the approval of the Bankruptcy Court and the partners of the

agent/owner. To date, the Repayment Agreement has not been executed and no monies have been collected by HUD because of problems with obtaining the partners' approvals.

The other case referred to by Ms. Dunlap involves a multifamily agent/owner which we audited in 1991 and again in 1993. We have reported over \$5 million in misspent project funds. As part of the resolution of these audits, a settlement agreement between HUD and the owner required the owner to: (1) pay HUD \$500,000 to settle litigation initiated by HUD to resolve the 1991 audit; and (2) repay the projects the amounts agreed upon by HUD and the owner as improperly spent by the owner. The agreement makes no reference to civil money penalties. The amounts to be repaid will be derived from the resale of the projects under HUD's low-income housing preservation programs which will provide the funds for the repayments. The repayments have not yet been made by the owner.

Rent Comparability Studies

During the hearing, Ms. Dunlap indicated that HUD is planning to change the basis on which Section 8 rent increases are set, using operating expenses of the assisted properties. We understand this to mean that HUD is attempting to develop Annual Adjustment Factors (AAFs) which would be based on actual increases in projects' operating costs in given geographical areas, rather than the current inflationary increases derived from changes in the Consumer Price Index. Ms. Dunlap also indicated that our respective offices have been meeting on this matter. While our offices have indeed been discussing this important matter, agreement on a plan of action has not been reached.

The issue of annual rent increases for Section 8 projects is a long-standing problem that continues to cost HUD millions in excessive subsidies each year. These unnecessary and unreasonable subsidies continue because HUD has not yet issued regulations for performing rent comparability tests as required by Section 8 contracts.

We first reported this problem to HUD management in 1985. More recently, we reported the problem of excessive Section 8 rent increases in our October 1992 and April 1993 audit reports on the refunding or refinancing of Section 8 projects financed with tax-exempt bonds. The primary issue involving refunded bond projects was that, under the method used to refinance the mortgages, annual rent adjustment factor were being applied to pre-refinancing contract rents which resulted in excessive rent increases. While the Office of Housing agreed to pursue other methods for adjusting Section 8 rents, we have been unsuccessful in

agreeing upon a workable method for eliminating excessive rent increases.

We agree that the methodology referenced by Ms. Dunlap could be a less staff intensive manner to provide rents and subsidies that are reasonable when compared to rent comparability tests. However, the Office of Housing has expressed concerns to us that HUD does not currently have the capability to implement such a methodology and was unsure when such a procedure could be put in place.

Until such time as a more effective method than comparability studies is developed, we believe that HUD needs to take immediate steps to issue and implement its comparability study regulations and related instructions .

We welcome the opportunity to work with you and your staff to address the problems confronting HUD in administering its Section 8 project-based programs. We also look forward to briefing you and your staff on our "Operation Safe Home" initiative.

Sincerely,

A handwritten signature in dark ink, appearing to read "Susan Gaffney". The signature is fluid and cursive, with a large, stylized "S" and "G".

Susan Gaffney
Inspector General

COMMITTEE ON GOVERNMENT OPERATIONS
SUBCOMMITTEE ON EMPLOYMENT, HOUSING AND AVIATION
SECTION 8 HOUSING

WRITTEN TESTIMONY OF ROGERLINE NICHOLSON, PRESIDENT OF EDGEWOOD
TERRACE I RESIDENTS' ASSOCIATION, INC.

Mr. Chairman and Members of the Committee:

My name is Rogerline Nicholson, President of the Edgewood Terrace I Residents Association, Inc. at Edgewood Terrace I ("Edgewood"). I have lived at the property for 20 years. The residents created the Residents' Association at Edgewood about four years ago because we wanted to be a force for positive change at the property.

I remember Edgewood at its best in the 1970's. The grounds were clean. The area were safe. There was no drug dealing or gambling at all. There was even a well-maintained swimming pool for all of us to swim in. It was a fine place to live and to raise your children.

Today, nearly twenty years later, the property is in serious disrepair. After years of neglect of maintenance, the systems have broken down. Rehabilitation is an absolute necessity. We are tired of the excuses we hear on a daily bases as to why this item or that item cannot be fixed. I welcome you to take even a quick visit to Edgewood and you will see why we need help.

Yet with all of the problems we face today, I am also here to tell you that we still believe in Edgewood, and our community remains strong. We have a deep commitment to the Edgewood neighborhood, and we have a strong social investment in seeing it improved to its former condition. Edgewood is a 292 unit property, and the Edgewood community as a whole is home to over 800 families. Edgewood is in an excellent location with a good blend of homeowners and apartment dwellers. There is a shopping center and many retail stores conveniently nearby. Transportation is accessible, with bus lines and a metro station within walking distance, which is an enormous benefit for our elderly residents, and for the many residents who do not drive. There are two elementary schools, one junior high, and one high school, all within walking distance. There are also numerous churches and hospitals in the neighborhood. In addition, our community support has been generous. Many groups and individuals have given their time to work with the residents on creating a comprehensive plan involving health services and outreach for the community. Thus, we are very concerned to hear that Edgewood could ever be closed down. Any decision to demolish Edgewood might solve HUD's problems. But it will be incredibly shortsighted since this property impacts the entire Edgewood community, not just the families who live there.

To give you an indication of the type of support we have at Edgewood, and why the future of our people remains bright, I will mention but a few of the concerned groups who are working with us now: Beacon House Ministry which provides tutoring and after school care for our children; The Harrison Institute for Public Law at Georgetown University which is providing legal support and training for the Association; Catholic University which has provided assistance in surveying the residents' needs and has developed a detailed plan for implementing community services at the site. In addition to these groups, Community Preservation and Development Corporation ("CPDC") has worked with us since 1991 as the potential developer of the site. CPDC has a detailed and workable plan for rehabilitation of the property that the residents support and that is economically viable.

The answer is not to give up, and rip apart the Edgewood community. The way to restore our homes to the dignity appropriate for our community is remember that accountability starts at the top. It is time for HUD to become responsive to the residents' requests, and take an active concern for the conditions at our property. Even having a simple phone call returned from HUD is a major undertaking. We are asking no more than for restoring Edgewood to a decent place for our families to live - but we are also asking for no less than a governmental commitment to become responsive to the residents' concerns.

In closing, I would summarize the wishes of the residents as follows; First, we want to stay at Edgewood; Second, we want HUD to commit the resources necessary to restore Edgewood to the place it once was and could be again; and Third, we want HUD to start listening to the concerns of the residents and to allow the residents to have a greater say in the decision-making process about the future course of Edgewood, which after all, is our home. We have invested considerable time and energy, as have the organizations working with us, to ensure that Edgewood will have the type of future that all of the residents deserve. We do not want to see this effort go to waste. Thank you.

STATEMENT OF REPRESENTATIVE JAMES BILBRAY
SUBMITTED TO THE SUBCOMMITTEE ON
EMPLOYMENT, HOUSING AND AVIATION
OF THE
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS
OCTOBER 6, 1994

Mr. Chairman, thank you for the opportunity to submit testimony before the Subcommittee today. I would like to begin by commending the efforts of this Subcommittee, and especially you Chairman Peterson, in bringing into the light deficiencies in the Section 8 housing program.

I have recently visited one of the worst federally funded housing projects in the nation. I am sad to say that it is located in my Congressional District. The Sierra Nevada Arms Apartments are a dismal example of what our federal housing programs can become if left improperly supervised.

I toured the Sierra Nevada Arms with HUD Assistant Secretary Andrew Cuomo. The conditions we witnessed are absolutely horrendous. We saw buildings in desperate need of repair. Some were gutted by fire, others in conditions that were totally uninhabitable.

Children were left to play on a hard-dirt playground just a few feet from these burned-out buildings where exposed electrical wiring was within easy reach of any curious child. Residents had attempted to put up make-shift fences to protect their children from these conditions, however, their effectiveness against a curious child was questionable.

During the tour, Assistant Secretary Cuomo himself said, "We have to do something about this. It is wrong to have children subjected to this. Human beings should not have to live this way."

Mr. Chairman, I could not agree more.

The Sierra Nevada Arms is a 352 unit project. It has received below average or unsatisfactory ratings from HUD for the past five years. Yet Sierra Nevada Arms continues to collect more than one million dollars each year in federal housing subsidies. This situation is simply outrageous. Something must be done.

Throughout this bureaucratic debacle, there is a bottom line. It is the residents who suffer. The people we are trying most to help are not being served. Our federal dollars are being wasted. We are not achieving our goals.

HUD now holds the mortgage on the Sierra Nevada Arms and may have to foreclose on the property to rectify the tangled web of problems there.

I realize this Subcommittee is intent on finding solutions in this area. I look forward to working with you to move forward any recommendations you might arrive at in this area.

It is my hope that we can again find our original purpose - one of serving the American people. Let us find a way to assure our constituents that their federal tax dollars will be used to give a hand up to the people who need it most, rather than allowing slumlords to line their pockets.

Thank you Mr. Chairman.



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